ACE AVIATION

ACE AVIATION HOLDINGS INC.
ANNUAL REPORT 2005

ACE Aviation Holdings Inc.

Highlights

	Three months ended December 31, 2005	Three months ended December 31, 2004	% Change	Twelve months ended December 31, 2005	Combined (1) Period ended December 31, 2004	% Change
Financial (CDN dollars in millions except per share figures)						
Operating revenues	**2,362**	2,062		**9,830**	8,900	
Operating income (loss) before reorganization and restructuring items	**(35)**	(3)		**452**	117	
Reorganization and restructuring items	**-**	-		**-**	(871)	
Non-operating expense	**(88)**	(47)		**(85)**	(293)	
Income (loss) before non-controlling interest, foreign exchange gain and provision for income taxes	**(123)**	(50)		**367**	(1,047)	
Income (loss) for the period	**(103)**	15		**258**	(880)	
Operating margin before reorganization and restructuring items	**(1.5)%**	(0.1)%		**4.6 %**	1.3 %	
EBITDAR before reorganization and restructuring items (2)	**207**	193		**1,351**	1,146	
EBITDAR margin before reorganization and restructuring items	**8.8 %**	9.4 %		**13.7 %**	12.9 %	
Cash, cash equivalents and short-term investments	**2,181**	1,632		**2,181**	1,632	
Cash flows from (used for) operations	**34**	(426)		**675**	(66)	
Weighted average common shares used for computation - basic	**101**	90		**98**	-	
Weighted average common shares used for computation - diluted	**101**	90		**109**	-	
Earnings (loss) per share - basic	**$ (1.02)**	$ 0.17		**$ 2.63**	nm	
Earnings (loss) per share - diluted	**$ (1.02)**	$ 0.17		**$ 2.46**	nm	
Operating Statistics						
Revenue passenger miles (millions) (RPM)	**10,584**	9,681	9	**46,764**	43,427	8
Available seat miles (millions) (ASM)	**13,808**	12,815	8	**58,822**	56,536	4
Passenger load factor	**76.7 %**	75.5 %	1.2 pt	**79.5 %**	76.8 %	2.7 pt
Passenger revenue yield per RPM (excluding Aeroplan) (cents) (3)	**17.9**	16.9	6	**17.0**	16.7	2
Passenger revenue yield per RPM (including Aeroplan) (cents) (3)	**18.6**	17.3	7	**17.6**	16.8	5
Passenger revenue per ASM (excluding Aeroplan) (cents) (3)	**13.7**	12.8	8	**13.5**	12.8	6
Passenger revenue per ASM (including Aeroplan) (cents) (3)	**14.2**	13.1	9	**14.0**	12.9	9
Operating revenue per available seat mile (cents)	**17.1**	16.1	6	**16.7**	15.7	6
Operating expense per available seat mile (cents)	**17.4**	16.1	8	**15.9**	15.5	3
Operating expense per available seat mile, excluding fuel expense (cents)	**13.2**	12.7	4	**12.2**	12.7	(4)
Average number of full-time equivalent (FTE) employees (thousands)	**33.1**	32.0	3	**32.5**	32.5	0
Available seat miles per FTE employee (thousands)	**417**	401	4	**1,811**	1,738	4
Operating revenue per FTE employee (thousands)	**$ 71**	$ 64	11	**$ 303**	$ 274	11
Aircraft in operating fleet at period end	**322**	290	11	**322**	290	11
Average aircraft utilization (hours per day) (4)(5)	**10.0**	9.8	2	**10.6**	10.2	4
Average aircraft flight length (miles) (5)	**842**	837	1	**871**	847	3
Fuel price per litre (cents) (6)	**66.0**	54.6	21	**60.0**	46.2	30
Fuel litres (millions)	**870**	786	11	**3,641**	3,460	5

(1) Reference to "Predecessor Company" refers to Air Canada and its subsidiaries prior to September 30, 2004. Annual Supplementary Non-GAAP Combined information (Combined) is the combination of the Predecessor Company's operations and financial results for the nine months ended September 30, 2004 added to ACE's (Successor Company) operations and financial results for the three months ended December 31, 2004. Refer to the MD&A for a reconciliation of the 2004 Annual Supplementary Non-GAAP Combined information.

(2) 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 depreciation, amortization and obsolescence as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. 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:

	Three months ended December 31		Twelve months ended December 31	
	Successor Company		Successor Company	Combined (1)
	2005 ($ millions)	2004 ($ millions)	**2005** ($ millions)	2004 ($ millions)
Operating income (loss) before reorganization and restructuring items	(35)	(3)	452	117
Add back:				
Aircraft rent	117	111	417	632
Depreciation, amortization & obsolescence	125	85	482	397
EBITDAR before reorganization and restructuring items	**207**	193	**1,351**	1,146

(3) Beginning in October 2004, Aeroplan redemption revenues related to points redeemed for travel on Air Canada and Jazz are reflected in the Passenger revenue category. Prior to October 2004, these revenues were recorded in the Other revenue category. Refer to the MD&A for more information.

(4) Excludes maintenance down-time.

(5) Excludes third party carriers operating under capacity purchase arrangements.

(6) Includes fuel handling and fuel hedging expenses.

TABLE OF CONTENTS

Page

MESSAGE FROM THE CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, ACE AVIATION HOLDINGS INC. 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS 4

PREFACE 4

EXPLANATORY NOTES 5

OVERVIEW AND GENERAL BUSINESS SUMMARY 11

CONSOLIDATED RESULTS OF OPERATIONS – FOURTH QUARTER ANALYSIS 15

CONSOLIDATED RESULTS OF OPERATIONS – 2005 VERSUS 2004 COMBINED 21

THE STATEMENT OF FINANCIAL POSITION AND LIQUIDITY 33

FINANCIAL MANAGEMENT – 2005 VERSUS 2004 COMBINED 39

FLEET 42

PEOPLE 43

QUARTERLY FINANCIAL DATA 45

SEGMENT INFORMATION 46

OFF-BALANCE SHEET ARRANGEMENTS 51

CHANGES IN ACCOUNTING POLICIES 52

CRITICAL ACCOUNTING ESTIMATES 53

SENSITIVITY OF CONSOLIDATED RESULTS 57

RISK FACTORS 58

CONTROLS AND PROCEDURES 65

OUTLOOK 66

SUBSEQUENT EVENTS 67

CONSOLIDATED FINANCIAL STATEMENTS AND NOTES 71

BOARD OF DIRECTORS / SENIOR MANAGEMENT TEAM 136

INVESTOR AND SHAREHOLDER INFORMATION 137

ACE passed its first big test last year with flying colors. Not only did we demonstrate that the assumptions underpinning our new business model are sound, but also that the model is robust and resilient.

I say robust, because ACE began unlocking significant asset value in the Air Canada franchise that had not been adequately recognized by Bay Street or Wall Street. In selling a first tranche of Aeroplan, we stuck by our view that it was an attractive investment opportunity that the market would value above most external estimates, which it did. Since being listed, the units have traded at a substantial premium. In January, the IPO of Jazz, our regional carrier, was also successful.

I say resilient because the Corporation's $258 million net profit was achieved despite soaring world crude prices that pushed up our jet fuel cost by $592 million on a consolidated basis over 2004. Our per litre price was 30 percent higher. If not for fuel, ACE would have exceeded its EBITDAR forecast for 2005 of $1.6 billion. A fuel spike of this magnitude was the kind of external shock like SARS and 9/11 that would have pushed the old Air Canada deep into red ink. This time, with a lower cost base and a new, popular commercial strategy, the measures undertaken to offset higher fuel, including service adjustments, fare increases and fuel surcharges, were sufficient to keep us in the black. Even with higher fares, demand remained strong, and with good reason. Customers like the solid value Air Canada offers. An airline doesn't achieve 23 consecutive months of record load factors, eight percent traffic growth, and improving yields as we did in 2005 without a very good product delivered with professionalism by its employees.

ACE intends to keep proving its model to cement the confidence of financial markets and achieve one of our goals, which is to lower our cost of capital as we enter a period of accelerated fleet renewal, expansion and refurbishing. Our projected capital expenditures for the next two years alone total about $3.4 billion. Most of this investment will go into acquiring new aircraft, giving us a vastly superior product to most major North American airlines. The added capacity and unique capabilities of these new aircraft will enable Air Canada to introduce more nonstop routes and add frequencies on existing routes while offering more consistent schedules throughout the year and more passenger comforts, all of which will be appealing to the highest yielding segment of our customer base, frequent business travelers. This will provide Air Canada with a sound platform for traffic growth and yield enrichment. We have committed financings for all of our new planes. Using them to replace older aircraft in the fleet will provide debt and lease savings that will partly offset the cost of the new aircraft.

Since May 2005, ACE has raised $1.27 billion in the equity markets, including $497 million through the Aeroplan and Jazz trust issues. The portion that ACE retains – 75.5 percent of Aeroplan and 79.7 percent of Jazz – represents a combined market capitalization of approximately $2.9 billion, or close to $26 per ACE share. Going forward, one of our major objectives is seeing our other assets, including Air Canada, the world's 14th largest airline, fully reflected in the share price. For the risk shareholders have taken, for the capital they provided that is helping support fleet renewal, network expansion, strategic investments and organic growth, shareholders should share in ACE's success. March's special distribution of Aeroplan units was intended to reward their confidence in our business model.

ACE's success has been furthered by two particular traits of our philosophy: decisiveness, and a drive to innovate. Our restructuring took 18 months, considerably less time than most US airlines have taken with theirs. In short order, we have rolled out a new livery, new employee uniforms, a new website, a plethora of new pass products, new aircraft and aircraft orders, new intercontinental routes,

new seats and entertainment systems in all aircraft including a luxurious suite with an industry leading lie-flat bed for our Executive First cabins, an international freighter network and new maintenance subcontracts from US carriers.

Air Canada's simplified fare structure is exceeding expectations for revenue generation, repositioning the airline for success in a lower-fare environment. The extent to which we are driving certain strategic approaches is unique among major North American airlines. ACE is:

- using a holding company structure to improve the operating and financial performance of each business unit or subsidiary by operating them as standalone businesses;
- changing the Air Canada commercial model to offer an improved value proposition to consumers that is cheaper to administer;
- pursuing a company-wide focus on process and policy simplification;
- encouraging organic growth through diversification, like establishing an international freighter network for Cargo and including freighters in the airline's Boeing widebody order. At $620 million, cargo revenues last year were 12 percent higher than 2004 and 19 percent more than 2003, largely on account of ramping up freighter flying as well as the addition of more transpacific and Latin American passenger flights that carry cargo.
- introducing new capabilities to our North American fleet and reconfiguring our intercontinental fleet to maximize use of Air Canada's unrivalled international route rights, including new fifth freedom rights to pick up passengers in the US en route to overseas destinations;
- seeking out strategic investments like ACE's 6 percent investment in the restructured US Airways Group Inc.;
- having Aeroplan transform itself from a conventional frequent flyer program into a broadly based loyalty management program as a means of growing its business.

These are transformative changes for our business and the whole airline industry is watching.

Air Canada is permanently entrenched now in a low-fare world and must remain competitive on costs to offer low fares. The key is changing how we do business. Our objective is to foster a culture of perpetual cost reduction that focuses on productivity enhancement and process reform, especially simplification. Bookings or changes to bookings made through aircanada.com are the least expensive to process. Our plan is to migrate as much business as possible to the web site by extending our simplified fare grid to international routes and expanding our family of pass products. The cost to Air Canada of selling a pass is the same as selling a single ticket, so we can afford to sell an "electronic wallet" of 10 or 20 one-way flight credits at a discount, locking in a customer's patronage. The flexibility of pass travel is liberating. It changes how frequent travelers do business and gives their employers additional savings and cost certainty. The first generation of passes is route- or market-specific. Over time, the concept will expand to accommodate just about any customer's travel pattern, however random. Our two-month, North America unlimited travel pass, offered last fall, was a forerunner of futuristic concepts that will redefine Air Canada as a seller of network access rather than seats.

Similarly, Jazz is launch customer for the 75-seat Canadair CRJ705 jet and Air Canada is one of the first to operate the 93-seat Embraer 190. These jets fill a gap in our fleet between 50 and 120 seats so we can better match capacity to demand for significant cost savings, add frequencies on a more cost-effective basis and overfly hubs. These smaller aircraft will give us a decisive edge in launching new services in a size and range category where other airlines cannot compete effectively because their aircraft are simply too large. We also envisage these new planes undertaking a greater variety of missions for Air Canada than they would for other carriers, which is why we have outfitted each with an Executive Class cabin and the same leading edge in-seat, audio-visual entertainment system scheduled for installation in our larger aircraft. The new intercontinental fleet, to be comprised exclusively of Boeing twin engine jets, will generate scheduling efficiencies, crew, parts and maintenance savings, and most importantly, every new 777 or 787 will be more fuel efficient – up to 30 percent more efficient for the 787 – than the aircraft it replaces.

The airline business is full of surprises. The best way for ACE to safely navigate the inevitable twists and turns is to stay one step ahead of the competition. That means never deviating from a strict focus on safety matters, while being aggressive, even audacious, on commercial strategy, accepting risk, knowing some mistakes will be made but that successes will far outnumber failures. Prior to our restructuring, low cost carriers were the risk-takers, and with so many constraints on Air Canada, we were reduced to reacting. Now the tables are turned. Our creative potential has been unleashed and competitors are imitating our concepts. We can never allow ourselves to fall into the trap of complacency, and by avoiding it, we have an excellent chance to repeat our successes, again and again.

Robert A. Milton
Chairman, President and Chief Executive Officer

PREFACE

ACE Aviation Holdings Inc. (ACE), incorporated on June 29, 2004, is the parent holding company, directly or indirectly, of various transportation and other service companies and partnerships including the following principal operating companies and partnerships: Air Canada, AC Cargo Limited Partnership (Air Canada Cargo), ACGHS Limited Partnership (ACGHS), Touram Limited Partnership (Air Canada Vacations), Jazz Air LP (Jazz or Jazz LP), and ACTS Limited Partnership (ACTS). In addition, the Corporation holds an 85.6 per cent ownership in Aeroplan Limited Partnership (Aeroplan or Aeroplan LP).

Reference to "Corporation" in this Management Discussion and Analysis (MD&A) 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.

This MD&A is current as of February 9, 2006.

On September 30, 2004, Air Canada and certain subsidiaries emerged from creditor protection under the provisions of the Companies' Creditors Arrangement Act (Canada) (CCAA). Reference to "Predecessor Company" refers to Air Canada and its subsidiaries prior to September 30, 2004. In accordance with Section 1625 of the Canadian Institute of Chartered Accountants (CICA) Handbook, Comprehensive Revaluation of Assets and Liabilities (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 to those of the Corporation.

The consolidated financial statements are expressed in millions of Canadian dollars and are prepared in accordance with Generally Accepted Accounting Principles (GAAP) in Canada. The accounting policies of ACE are consistent with those of the Predecessor Company, with the exception of the fair value adjustments applied under fresh start reporting and certain accounting policies as outlined in Note 2 to the 2005 Annual Consolidated Financial Statements of ACE.

The consolidated statement of operations and the consolidated statement of cash flow for the three months ended December 31, 2005 and for the three months ended December 31, 2004 both reflect the results of operations of the Corporation. Consequently, the financial information for the fourth quarter of 2005 is directly comparable to that of the fourth quarter of 2004 with the exception of the adoption of Accounting Guideline 15 – Consolidation of Variable Interest Entities (AcG-15) on January 1, 2005, as further described in Note 2 to the 2005 Annual Consolidated Financial Statements of ACE. The consolidated statement of financial position as of December 31, 2005 and December 31, 2004 represents the accounts of the Corporation.

The consolidated statement of operations and the consolidated statement of cash flow for the year ended December 31, 2005 reflect the results of the Corporation. The consolidated statement of operations and the consolidated statement of cash flow for the nine months ended September 30, 2004 reflect the results of the Predecessor Company; the consolidated statement of operations and the consolidated statement of cash flow for the period from the incorporation of ACE to December 31, 2004 reflect the results of the Corporation. Refer to the section entitled "Non-GAAP Financial Measures" on page 6 of this MD&A for additional information on the 2004 results of operations.

For further information on ACE's and Air Canada's public disclosure file, including ACE's Annual Information Form, please consult SEDAR at *www.sedar.com*.

EXPLANATORY NOTES

GLOSSARY OF TERMS

Revenue Passenger Miles (RPMs)
Revenue Passenger Miles is 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)
Available Seat Miles is a measure of passenger capacity calculated by multiplying the total number of seats available for revenue traffic by the miles flown.

Passenger Load Factor
Passenger Load Factor is 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)
Average passenger revenue per revenue passenger mile.

Passenger Revenue per Available Seat Mile (RASM)
Average passenger revenue per available seat mile.

"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.

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. 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 as well as the factors identified throughout this MD&A and, in particular, those identified in the Risk Factors section to this MD&A. The forward-looking statements contained in this discussion represent ACE's expectations as of February 9, 2006, 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.

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.

NON-GAAP FINANCIAL MEASURES

Annual Supplementary Non-GAAP Combined Information for the year 2004

The Annual Supplementary Non-GAAP Combined Information for the year 2004 is the combination of financial results for the nine months ended September 30, 2004 of the Predecessor Company and financial results for the period ended December 31, 2004, which represents three months of operations, of the Corporation. Such combination is for illustrative purposes only. This combined information will hereinafter be referred in this MD&A as "Combined" information or "2004 Combined". As a result of the application of fresh start reporting, application of new accounting policies, the effectiveness of certain lease contracts on emergence from CCAA and the debt and equity transactions that occurred on September 30, 2004, the Corporation's financial statements are not directly comparable to those prepared for the Predecessor Company prior to the emergence. The combination of the financial information of Air Canada and ACE for the year ended December 31, 2004 should not be viewed as a continuum because the financial statements of Air Canada for periods prior to October 1, 2004 and the financial statements of ACE for the period ended December 31, 2004 are those of different reporting entities and are prepared using different bases of accounting and different accounting policies and are therefore not directly comparable.

2004 Combined Income Statement ($ millions)	ACE Three months ended December 31, 2004	Air Canada Nine months ended September 30, 2004	2004 Combined
Operating Revenues			
Passenger	1,681	5,628	7,309
Cargo	151	405	556
Other	230	805	1,035
	2,062	6,838	8,900
Operating Expenses			
Salaries, wages and benefits	596	1,989	2,585
Aircraft fuel	432	1,174	1,606
Aircraft rent	111	521	632
Other	926	3,034	3,960
	2,065	6,718	8,783
Operating income (loss) before restructuring and reorganization items	(3)	120	117
Reorganization and restructuring items	-	(871)	(871)
Non-operating expense	(47)	(246)	(293)
Foreign exchange gain	78	104	182
Provision for income taxes	(13)	(2)	(15)
Income (loss) for the period	15	(895)	(880)

2004 Combined Statement of Cash Flow

($ millions) Cash flows from (used for)	ACE Three months ended December 31, 2004	Predecessor company Nine months ended September 30, 2004	2004 Combined
Operating			
Income (loss) for the period	15	(895)	(880)
Adjustments to reconcile to net cash provided by operations:			
Reorganization and restructuring items	-	786	786
Depreciation, amortization and obsolescence	85	312	397
Loss on sale of and provisions on assets	-	75	75
Foreign exchange	(98)	(104)	(202)
Future income taxes	11	(5)	6
Employee future benefit funding (more than) less than expense	(52)	126	74
Decrease (increase) in accounts receivable	269	(191)	78
Decrease (increase) in spare parts, materials & supplies	(30)	-	(30)
Increase (decrease) in accounts payable & accrued liabilities	(256)	34	(222)
Increase (decrease) in advance ticket sales, net of restricted cash	(77)	196	119
Aircraft lease payments in excess of rent expense	(14)	(31)	(45)
Other	35	57	92
Cash flows from (used for) operating activities before the following items:	(112)	360	248
Settlement of lease obligations	(290)	-	(290)
Rebate on lease settlement	33	-	33
Payment of restructuring obligation	(45)	-	(45)
Fees conditional on emergence	(12)	-	(12)
	(426)	360	(66)
Financing			
Issue of share capital	1	-	1
Aircraft-related borrowings	-	233	233
Credit facility borrowings	-	80	80
Reduction of long-term debt and capital lease obligations	(67)	(358)	(425)
Preferred shares issued to Cerberus for cash	238	-	238
Shares issued for cash under rights offering	852	-	852
GE DIP financing	(300)	300	-
Drawdown of Exit Financing	527	-	527
Other	-	(2)	(2)
	1,251	253	1,504
Investing			
Short-term investments	(151)	186	35
Additions to capital assets	(129)	(328)	(457)
Proceeds from sale of assets	-	2	2
Cash collateralization of letters of credit	(21)	-	(21)
	(301)	(140)	(441)
Increase in cash and cash equivalents	524	473	997
Cash and cash equivalents, beginning of period	-	484	484
Cash and cash equivalents, transferred to the Corporation	957	(957)	-
Cash and cash equivalents, end of period	1,481	-	1,481

EBITDAR

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 depreciation, obsolescence and amortization, as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets.

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:

($ millions)	ACE Three months ended December 31, 2005	ACE Three months ended December 31, 2004	$ Change	ACE Twelve months ended December 31, 2005	Combined Twelve months ended December 31, 2004	$ Change
GAAP operating income before reorganization and restructuring items [1]	(35)	(3)	(32)	452	117	335
Add back:						
Aircraft rent	117	111	6	417	632	(215)
Depreciation, amortization and obsolescence	125	85	40	482	397	85
EBITDAR, before reorganization and restructuring items [1]	207	193	14	1,351	1,146	205
EBITDAR margin (%) [2]	8.8	9.4	(0.6) pp	13.7	12.9	0.8 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 Corporation 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.*

EBITDAR by segment

($ millions)	Three months ended December 31, 2005					
	Transportation Services	Aeroplan	Jazz	ACTS	Inter-Segment Elimination	ACE Consolidated
GAAP operating income	(91)	30	34	(8)	-	(35)
Add back:						
Aircraft rent	90	-	28	-	(1)	117
Depreciation, amortization and obsolescence	110	3	4	8	-	125
EBITDAR	**109**	**33**	**66**	**0**	**(1)**	**207**

($ millions)	Three months ended December 31, 2004					
	Transportation Services	Aeroplan	Jazz	ACTS	Inter-Segment Elimination	ACE Consolidated
GAAP operating income	(58)	22	22	11	-	(3)
Add back:						
Aircraft rent	103	-	9	-	(1)	111
Depreciation, amortization and obsolescence	73	1	4	7	-	85
EBITDAR	**118**	**23**	**35**	**18**	**(1)**	**193**

($ millions)	Twelve months ended December 31, 2005					
	Transportation Services	Aeroplan	Jazz	ACTS	Inter-Segment Elimination	ACE Consolidated
GAAP operating income	174	102	129	47	-	452
Add back:						
Aircraft rent	343	-	80	-	(6)	417
Depreciation, amortization and obsolescence	424	8	18	32	-	482
EBITDAR	**941**	**110**	**227**	**79**	**(6)**	**1,351**

AEROPLAN LOYALTY PROGRAM

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

Effective September 30, 2004, Miles redeemed for travel on Air Canada and Jazz are included in the Passenger revenue category and Miles redeemed for other than travel are included in the Other revenue category. Under the accounting policy in the Predecessor Company, Aeroplan redemption revenues from Miles earned by members through loyalty program partners were included in the Other revenue category.

The net of passenger revenues from Miles redeemed for travel on Air Canada and Jazz and the reduction to passenger revenues for the fair value of Miles issued on qualifying travel on Air Canada and Jazz is 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) ACE Accounting Policy	2005	2004
Aeroplan Miles redeemed for travel on Air Canada and Jazz		
Miles earned through air transportation services	164	30
Miles earned through loyalty program partners	305	54
	469	84
Less the deferral of the fair value of Miles issued	(179)	(43)
Net recorded in Passenger revenue	290	41
Predecessor Company Accounting Policy		
Miles earned through loyalty program partners and redeemed for travel on Air Canada and Jazz (recorded in Other revenue)	-	173

OVERVIEW AND GENERAL BUSINESS SUMMARY

ACE is the parent holding company of Air Canada and ACE's other subsidiaries.

Air Canada is Canada's largest domestic and international full-service airline and the largest provider of scheduled passenger services in the domestic market, the US transborder market and each of the Canada Europe, Canada Pacific, Canada Caribbean/Central America and Canada South America markets. Passenger transportation is the principal business of the Corporation and, in 2005, represented 84 per cent of its total operating revenues.

Air Canada and Jazz, the Corporation's regional carrier, operate an extensive domestic, US transborder and international network. During 2005, Air Canada and Jazz operated, on average, approximately 1,200 scheduled flights each day and carried over 30 million passengers. In 2005, Air Canada and Jazz provided direct passenger air transportation to 159 destinations and, through commercial agreements with other unaffiliated regional airlines referred to as Tier III carriers, to an additional 11 destinations, for a total of 170 direct destinations on five continents. The Corporation's primary hubs are located in Toronto, Montréal, Vancouver and Calgary. In 2005, an independent survey by Skytrax of more than 12 million international air travelers ranked Air Canada as the Best Airline in North America.

Air Canada also operates an extensive global network in conjunction with its international partners. Air Canada is a founding member of the Star Alliance network, the world's largest airline alliance group. The Star Alliance network has grown, since its inception, to include 16 members and three regional members. Through its strategic and commercial arrangements with Star Alliance members and several other airlines, Air Canada offers service to over 795 destinations in 139 countries, with reciprocal participation in frequent flyer programs and use of airport lounges.

The Corporation has a controlling interest in Aeroplan which operates Canada's premier loyalty program. Aeroplan provides its commercial partners with loyalty marketing services designed to attract and retain customers and stimulate demand for such partners' products and services. Aeroplan's objective is to offer its commercial partners superior value relative to other marketing alternatives through access to Aeroplan's base of members and the design and execution of marketing programs aimed at increasing revenue, market share, and customer loyalty. The Aeroplan program is one of Canada's longest standing loyalty programs. It was founded in 1984 by Air Canada to manage the airline's frequent flyer program. Aeroplan benefits from its unique strategic relationship with Air Canada in addition to its contractual arrangements with leading commercial partners including AMEX, Bell Canada, CIBC, Future Shop, Imperial Oil (Esso), Star Alliance member airlines and numerous hotel chains and car rental companies.

Aeroplan offers its approximately five million active members the ability to accumulate Aeroplan Miles throughout its partner network through purchases of products and services. Aeroplan sells Aeroplan Miles to its extensive network of over 60 commercial partners, representing over 100 brands in the financial services, travel services and consumer products and services industries. Today, financial services partners generate the majority of Aeroplan's revenues.

Jazz is the largest regional airline and the second largest airline in Canada after Air Canada, based on fleet size and number of routes operated. Jazz forms an integral part of Air Canada's domestic and US transborder market presence and strategy. Jazz and Air Canada are parties to a capacity purchase agreement (CPA) effective September 30, 2004, pursuant to which Air Canada currently purchases substantially all of Jazz's fleet capacity based on predetermined rates. Under the CPA with Air Canada, Jazz

provides service to and from lower density markets as well as higher density markets at off-peak times throughout Canada and to and from certain destinations in the United States. Jazz currently operates scheduled passenger service on behalf of Air Canada, with approximately 688 departures per weekday to 56 destinations in Canada and 17 destinations in the United States with an operating fleet of 121 aircraft as of December 31, 2005. Jazz and Air Canada have linked their regional and mainline networks in order to serve connecting passengers more efficiently and to provide valuable traffic feeds to Air Canada's mainline routes.

The Corporation also provides technical services through ACTS. ACTS is a full-service Maintenance, Repair and Overhaul (MRO) organization that provides airframe, engine and component maintenance and various ancillary services to a wide range of more than 100 global customers. ACTS operates maintenance centers across Canada, with principal centers located in Montréal, Toronto, Winnipeg and Vancouver.

The Corporation also provides cargo services through Air Canada Cargo; ground handling services through ACGHS; and tour operator services and leisure vacation packages through Air Canada Vacations.

BUSINESS STRATEGY

In order to respond to a rapidly changing landscape, the Corporation has fundamentally changed its business strategy and has been redesigning its business processes since emergence from CCAA. ACE designed and embarked on a new business plan to:

(i) consolidate its domestic market position through a superior product offering at a competitive cost;
(ii) provide a sustainable foundation for its growing international markets; and
(iii) highlight the value inherent in ACE's subsidiaries.

The Corporation's new business strategy is based on the following four major components:

(i) a competitive cost structure;
(ii) a redesigned network to maximize efficiency and leverage international growth opportunities;
(iii) a new revenue model for passenger services; and
(iv) a new corporate structure to facilitate the implementation of strategic initiatives and to surface the value of its subsidiaries.

COMPETITIVE COST STRUCTURE

The Corporation's new business strategy is built on a significantly improved competitive cost structure. During the CCAA restructuring process and since emerging from the process, the following three main focus areas have contributed significantly to the Corporation's benefit:

(i) Through the CCAA restructuring process, the Corporation dramatically reduced its operating costs.
(ii) Following this, the Corporation embarked on a substantial re-engineering process to simplify its internal processes and reduce its costs even further by eliminating non-value adding tasks and procedures. This is an ongoing process of continuous improvement.
(iii) Additionally, the Corporation has created a new business model whereby its customers can be served directly using web-enabled technology which is envisaged to further eliminate substantial external non-value adding processes between the Corporation and its customers. This too is an ongoing process of continuous improvement.

Stemming from the above focus areas, the Corporation has realized and envisages continuing to benefit from substantial cost reductions in the following areas:

(i) substantially reduced supplier obligations, including aircraft and real estate;
(ii) significantly improved labour productivity due to a rationalized work force and lower average salaries;
(iii) lower trip costs due to better matching of capacity with demand;
(iv) higher operating efficiencies through its fleet modernization program;
(v) lower pilot training, inventory carrying and maintenance costs by reducing the number of aircraft types;
(vi) significantly lower sales and distribution costs by improved and easy to use web-enabled technology for its customers;
(vii) dramatically lower internal costs by eliminating business processes which do not fit the new revenue model.

Unlike its low-cost competitors, the Corporation incurs costs related to the offer of value-added transportation services, such as Executive Class services and other non-air services. The Corporation believes that these costs are offset by a revenue premium,

driven primarily by higher passenger yield and passenger load factor, increased international connecting traffic and increased Aeroplan and cargo revenues. The Corporation expects to maintain this revenue premium by continuing to leverage its key competitive advantages, including:

(i) a more extensive route network, greater flight frequency and greater market presence;
(ii) value-added services, for which customers are willing to pay a premium, including unlimited schedule changes, same-day stand-by, advance seat selection, full Aeroplan mileage, concierge service and Executive Class service; and
(iii) higher yielding international (including US transborder) connections.

REDESIGNED NETWORK TO MAXIMIZE EFFICIENCY AND LEVERAGE INTERNATIONAL GROWTH OPPORTUNITIES

The Corporation's objective is to become the customer's clear choice in all the markets in which it competes by offering a better scheduled product at a competitive price. To this end, the Corporation's redesigned network focuses on offering better flight frequencies on key domestic and US transborder routes, while maintaining competitive frequency on other domestic and US transborder routes, and reducing the average seating capacity per departure.

Jazz, the Corporation's regional carrier, forms an integral part of Air Canada's domestic and US transborder market strategy. The Corporation expects to achieve its objectives through the increased use of large regional jet aircraft which have lower trip costs. This initiative, for which deliveries commenced in October 2004, will see Air Canada and Jazz add 90 new regional jet aircraft to their fleet by January 2008. By early 2006, the Corporation had received all fifteen 75-seat Bombardier CRJ705 aircraft and fifteen 75-seat Embraer ERJ175 aircraft under firm order as well as five 93-seat ERJ190 aircraft. Forty additional Embraer ERJ190 aircraft under firm order will be delivered in the remainder of 2006, during 2007 and in January 2008. In addition, as a result of agreements reached with Air Canada's and Jazz's unions during Air Canada's restructuring under the CCAA, all of the Corporation's Bombardier CRJ aircraft will be operated out of Jazz's regional operations. The Corporation expects that the lower trip costs of these regional jet aircraft will enable the Corporation to compete more effectively with low-cost carriers. This strategy should allow the Corporation to operate its network more efficiently by better matching capacity with demand and by facilitating connections in a timely fashion.

Since international services generally produce higher margins than domestic and transborder services, the Corporation also intends to expand its existing services to currently served international destinations as well as serve new international destinations. The Corporation believes that it is well positioned to grow its international services and increase its current market share by leveraging the following competitive advantages:

(i) its superior international network;
(ii) its widely recognized brand and its strong position in the market for trans-Atlantic and trans-Pacific travel to and from Canada and more recently the Canada-South America market; and
(iii) its ability to capitalize on the relative speed and convenience associated with having its hubs located in Canada which, unlike the United States, does not currently require a visa from residents of certain countries transiting through the country.

For domestic, US transborder and international services, the Corporation will continue to leverage the strengths of its Aeroplan program.

CUSTOMER DRIVEN REVENUE MODEL FOR PASSENGER SERVICES

The Corporation's new revenue model for passenger services is aimed at improving customer satisfaction and retention by focusing on simplicity, value, choice, transparency and flexibility for the customer and is resulting in greater passenger volume, higher passenger load factors and increased cost efficiency for Air Canada and Jazz.

The new revenue model is based on five simple fare types ranging from low one-way fares, substantially similar to those offered by low-cost carriers, to Executive Class fares. The new fares are based on a different combination of product attributes, including the ability to make changes to reservations, seat selection and Aeroplan mileage. The new model provides transparency by allowing customers to compare prices and travel options and select the most suitable fare. The Corporation believes that this establishes a clear link between price and value and will be a key driver in achieving customer loyalty.

The new revenue model was introduced in Air Canada's and Jazz's domestic markets in May 2003. In February 2004, the new revenue model was expanded to most destinations in the continental United States served by Air Canada and Jazz in cooperation with United Airlines, one of Air Canada's Star Alliance partners. On January 4, 2006, Air Canada expanded its low, simplified fare structure for flights to and from London Heathrow and Manchester. Air Canada plans to convert more international destinations

to its simplified fare structure in the near future. The Corporation believes that its increasing use of the internet to improve its distribution network has facilitated market acceptance of its new revenue model.

Another key step in the implementation of its new revenue model was the introduction in 2005 of a range of multi-trip online pass products that offer significant buy-in-bulk savings for frequent travelers. This product also provides online convenience that underlines Air Canada's commitment to lead the way by giving customers the ability to plan their travel budgets upfront and execute these plans with minimum variations. Among the products are Rapidair Flight Passes for travel between Toronto, Hamilton, Ottawa and Montréal, Western Canada Flight Passes for cities within Western Canada, City Flight Passes for travel within a specified radius around a city, Flight Passes to Sun destinations including Hawaii, Week-end Flight Passes and passes for businesses that permit travel on a pass by up to eight employees within a firm. In addition, in September of 2005, Air Canada expanded its line of multi-trip pass products to include the airline industry's first-ever subscription to unlimited flights. This "North America Unlimited Pass" provided pass holders the freedom to fly as often as they wished to more than 100 destinations served by Air Canada and Jazz in North America for a two-month period from October 1 to November 30, 2005 inclusive.

NEW CORPORATE STRUCTURE TO MAXIMIZE THE VALUE OF SUBSIDIARIES

A new corporate structure was established pursuant to which the various business segments that were formerly within Air Canada became stand-alone subsidiaries of ACE. The new corporate structure was designed to:

(i) put in place separate management and business plans for each subsidiary to better focus their strategic direction and profit making efforts;
(ii) align management, capital and human resource needs within each individual business;
(iii) facilitate the development of each business segment to its fullest individual potential including, where appropriate, through the pursuit of third party sources of business; and
(iv) maximize subsidiaries' value that was not fully recognized.

As part of this strategy to maximize shareholder value by surfacing the underlying value of its subsidiaries, in June 2005, ACE and the Aeroplan Income Fund completed an initial public offering of its loyalty management subsidiary as an income trust. Aggregate net proceeds of the offering were $267 million.

On February 2, 2006, the Jazz Air Income Fund (the Fund) sold 23.5 million units at a price of $10 per unit for estimated net proceeds of $222 million. The Fund is an unincorporated, open-ended trust created to indirectly acquire and hold 19.1 per cent of the outstanding limited partnership units of Jazz. ACE holds the remaining 80.9 per cent of the outstanding limited partnership units of Jazz.

The Fund has granted to the underwriters an over-allotment option (the Over-Allotment Option), exercisable for a period of 30 days following the closing date, to purchase up to 3.525 million additional units at $10 per unit for net proceeds of $33 million. In the event the underwriters exercise the Over-Allotment Option in full, the Fund and ACE will hold 22 per cent and 78 per cent of the outstanding limited partnership units of Jazz respectively.

ACE's subsidiaries are at varying stages of their corporate development, and maximizing value at these entities is a priority in the efforts of senior management. ACE's value enhancement strategy for its stand-alone subsidiaries includes considering stand-alone financings, sales or distributions of equity interests and involving outside investors for these and other purposes.

From time to time, ACE reviews acquisition opportunities in respect of businesses or assets that may be complementary to its own. Where appropriate, to increase shareholder value, ACE may consider entering into acquisitions and joint ventures.

In addition, ACE is pursuing internal growth opportunities at its various subsidiaries. In particular, Aeroplan intends to grow its revenues through greater access to Air Canada's network for mileage redemption and the addition of new partners across various retail segments. ACTS intends to leverage its expertise and develop its third party customer base, including US carriers that have recently increased their outsourcing of maintenance repair and overhaul work (MRO).

OTHER INVESTMENTS

On September 27, 2005, the Corporation invested $87 million (US$75 million) in US Airways Group Inc. (US Airways) in conjunction with the carrier's exit from US bankruptcy proceedings. The Corporation's investment represented approximately 6 per cent of the equity of US Airways at December 31, 2005.

CONSOLIDATED RESULTS OF OPERATIONS – FOURTH QUARTER ANALYSIS

The following table compares the consolidated results of operations of ACE for the fourth quarter of 2005 to the fourth quarter of 2004.

Consolidated Statement of Operations ($ millions, except per share figures) (Unaudited)	ACE Three months ended December 31, 2005	ACE Three months ended December 31, 2004	$ Change	% Change
Operating revenues				
Passenger	1,969	1,681	288	17
Cargo	176	151	25	17
Other	217	230	(13)	(6)
	2,362	**2,062**	**300**	**15**
Operating expenses				
Salaries, wages and benefits	648	596	52	9
Aircraft fuel	578	432	146	34
Aircraft rent	117	111	6	5
Airport and navigation fees	222	198	24	12
Aircraft maintenance, materials and supplies	104	78	26	33
Communications and information technology	73	66	7	11
Food, beverages and supplies	81	76	5	7
Depreciation, amortization and obsolescence	125	85	40	47
Commissions	47	65	(18)	(28)
Other	402	358	44	12
	2,397	**2,065**	**332**	**16**
Operating loss	**(35)**	**(3)**	**(32)**	
Non-operating income (expense)				
Interest income	19	11	8	
Interest expense	(87)	(60)	(27)	
Interest capitalized	6	2	4	
Loss on sale of and provisions on assets	(30)	-	(30)	
Other	4	-	4	
	(88)	**(47)**	**(41)**	
Loss before the following items:	(123)	(50)	(73)	
Non-controlling interest	(8)	-	(8)	
Foreign exchange gain (loss)	(11)	78	(89)	
Recovery of (provision for) income taxes	39	(13)	52	
Income (loss) for the period	**(103)**	**15**	**(118)**	
Earnings (loss) per share				
- Basic	**(1.02)**	**0.17**	**(1.19)**	
- Diluted	**(1.02)**	**0.17**	**(1.19)**	
EBITDAR[(1)]	**207**	**193**	**14**	

Operating Statistics	ACE Three Months ended December 31, 2005	ACE Three Months ended December 31, 2004	Change	% Change
Revenue Passenger Miles (millions)	10,584	9,681	903	9
Available Seat Miles (millions)	13,808	12,815	993	8
Passenger Load Factor (%)	76.7	75.5	1.2 pp	

(1) Refer to "Non-GAAP Financial Measures" on page 8 of this MD&A for additional information on EBITDAR.

COMPARISON OF RESULTS – FOURTH QUARTER 2005 VERSUS FOURTH QUARTER 2004

ACE applied fresh start reporting on September 30, 2004 and, therefore, the fourth quarter of 2005 is directly comparable to the fourth quarter of 2004, with the exception of the adoption of AcG-15.

Aircraft fuel expense was the most significant expense increase, affecting profitability in 2005, rising $146 million or 34 per cent in the fourth quarter of 2005 and $592 million or 37 per cent for the full year of 2005, when compared to 2004 levels. In the first three quarters of 2005, excluding fuel expense, unit cost, as measured by operating expenses per ASM, showed quarter-over-quarter decreases which largely reflected the impact of fresh start reporting on the 2005 quarters, the continuing cost reduction initiatives and increased employee productivity. Excluding fuel expense, unit cost for the fourth quarter of 2005 rose 4 per cent over the fourth quarter of 2004. Ownership costs, comprised of aircraft rent and depreciation, were significant factors in the increase in unit cost, excluding fuel. Ownership costs, as well as other costs, were affected by the addition of 41 new regional aircraft, such as the Embraer ERJ175/190 and the Bombardier CRJ705 aircraft, with higher unit costs but with lower trip costs, and two extra freighters in the 2005 quarter. These freighters incurred operating costs but produced no ASMs. Higher aircraft maintenance material and supplies expense was another significant negative factor.

For the fourth quarter of 2005, ACE reported an operating loss of $35 million, a deterioration of $32 million compared to the operating loss of $3 million recorded in the same quarter of 2004. EBITDAR improved $14 million over the 2004 quarter. Refer to "Non-GAAP Financial Measures" on page 8 of this MD&A for additional information on EBITDAR.

In the fourth quarter of 2005, total operating revenues increased $300 million or 15 per cent compared to the fourth quarter of 2004. Passenger revenues were up $288 million or 17 per cent reflecting increases in all markets due to both a yield improvement of 7 per cent as well as an increase in passenger traffic of 9 per cent. The system yield improvement was primarily due to increased fare levels in the domestic and US transborder markets and significantly increased fuel surcharges in the international markets to cover higher fuel costs. An improved domestic competitive position and a stronger market demand for the higher-priced Tango Plus product, the next level up from the basic best value fare, providing additional features such as advance seat selection and increased Aeroplan points, were also factors in the domestic yield improvement. Additionally, US transborder yield also improved as a result of a redesign of conditions underlying fares aimed at the business-oriented market which occurred in the fourth quarter of 2005.

Operating expenses increased $332 million or 16 per cent versus the fourth quarter of 2004, including an increase in fuel expense of $146 million or 34 per cent over the fourth quarter of 2004. Capacity, as measured in available seat miles (ASM), increased 8 per cent. Unit cost for the fourth quarter of 2005, as measured by operating expense per ASM, increased 8 per cent from the fourth quarter of 2004.

In the fourth quarter of 2005, non-operating expense amounted to $88 million, an increase of $41 million from the fourth quarter of 2004. In the fourth quarter of 2005, loss on sale of and provisions on assets of $30 million was recorded, of which approximately $15 million related to the write-down of inactive Boeing 747 inventory.

Losses from revaluation of foreign currency monetary items and the impact of foreign currency derivative contracts totaled $11 million in the fourth quarter of 2005 and were mainly attributable to a weaker Canadian dollar versus the US dollar at December 31, 2005 compared to September 30, 2005. Foreign exchange gains of $78 million were recorded in the fourth quarter of 2004.

The Corporation recorded a recovery of income taxes of $39 million in the fourth quarter of 2005. This compared to a provision for income taxes of $13 million in the 2004 quarter.

Net loss for the fourth quarter of 2005 was $103 million compared to net income of $15 million recorded in the fourth quarter of 2004, a deterioration of $118 million.

REVENUE PERFORMANCE – FOURTH QUARTER 2005 VERSUS FOURTH QUARTER 2004

PASSENGER REVENUES

As a result of the inclusion of Aeroplan passenger revenues in passenger revenues starting in October 2004, as described on page 10 of this MD&A, the year-over-year percentage changes by quarter are not directly comparable, with the exception of the fourth quarter. For comparative purposes, 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			ACE					
	Quarter 1 2004	Quarter 2 2004	Quarter 3 2004	Quarter 4 2004	Quarter 1 2005	Quarter 2 2005	Quarter 3 2005	Quarter 4 2005	Quarter 4 2005 including Aeroplan
Canada	(9)	8	3	0	1	13	17	19	20
US	(13)	5	(1)	(17)	(13)	0	6	21	23
Atlantic	(5)	6	6	4	8	10	9	13	14
Pacific	15	162	113	35	14	11	5	6	7
Other	24	38	25	22	17	18	18	11	12
System (excluding Aeroplan)	(5)	15	12	1	1	10	12	16	
System (including Aeroplan)				4	5	14	16	17	17

The table below describes 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 4, 2005 versus Quarter 4, 2004	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	RASM % Change
Canada	20	7	7	0.4	12	12
US	23	8	12	2.7	9	14
Atlantic	14	11	13	1.4	0	2
Pacific	7	5	7	1.0	0	2
Other	12	8	8	0.0	5	5
System	17	8	9	1.2	7	9

As compared to the fourth quarter of 2004, system passenger revenues were up $288 million or 17 per cent in the fourth quarter of 2005. The passenger revenue growth versus the 2004 quarter was due to increases in both yield and passenger traffic. In the fourth 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 8 per cent in ASM flying capacity. As a result of the growth in passenger traffic, system passenger load factor improved 1.2 percentage points to 76.7 per cent, a record high load factor for the fourth quarter. System yield improved 7 per cent and reflected yield increases in all markets with the exception of the Atlantic and Pacific markets which remained unchanged. The system yield improvement was primarily due to increased fare levels in the domestic and US transborder markets. International fares remained under pressure in the quarter and the weakening of foreign currencies against the stronger Canadian dollar partially offset the additional revenue from fuel surcharges. An improved domestic competitive position and a stronger market demand for the higher-priced Tango Plus product were also factors in the domestic yield improvement. Additionally, US transborder yield also improved as a result of a redesign of conditions underlying fares aimed at the business-oriented market which occurred in the fourth quarter of 2005. System RASM rose 9 per cent over the fourth quarter of 2004, reflecting both the improvement in passenger load factor and the increase in yield.

Domestic passenger revenues amounted to $854 million in the 2005 quarter, an increase of $141 million or 20 per cent from the fourth quarter of 2004. Domestic traffic and ASM capacity were both up by 7 per cent resulting in a passenger load factor slightly above that of the fourth quarter of 2004. Capacity increases were largely on transcontinental services between Toronto and Calgary and Edmonton

as well as services within Western Canada. Domestic yield improved 12 per cent mainly due to increased 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, the next level up from the basic best value fare. The Tango Plus product provides additional features such as advance seat selection and increased Aeroplan points. Reflecting the yield improvement, domestic RASM rose 12 per cent above the 2004 level.

US transborder passenger revenues rose $73 million or 23 per cent in the fourth quarter of 2005 versus the fourth quarter of 2004. US transborder traffic grew 12 percent on an ASM capacity increase of 8 per cent resulting in a passenger load factor improvement of 2.7 percentage points. Capacity increases were largely on the Las Vegas route and on certain California routes such as San Francisco and San Diego. New services to Las Vegas were launched from Vancouver and Calgary and frequencies were increased from both Montréal and Toronto. The additional capacity to California reflected a new service from Vancouver to San Diego as well as increased frequencies on existing services. US yield improved 9 per cent partly reflecting the redesign of conditions underlying fares aimed at the business-oriented market which occurred in the fourth quarter of 2005 as well as increased fare levels to cover higher fuel costs. As a result of both the yield improvement and the higher passenger load factor, RASM was up 14 per cent from the fourth quarter of 2004.

Atlantic passenger revenues increased $44 million or 14 per cent in the fourth quarter of 2005. Despite increased fuel surcharges to cover higher fuel costs, Atlantic yield was essentially unchanged from the 2004 quarter reflecting a significant weakening of foreign currencies for sales denominated in euro and pound sterling as well as a competitive pricing environment as a result of growth in charter capacity to Europe and the United Kingdom. Atlantic traffic rose 13 per cent largely reflecting the addition of the routes to Zurich, Switzerland and to Rome, Italy and to a stronger market demand in France and the United Kingdom markets. Capacity increased 11 per cent largely due to the addition of the routes to Zurich and to Rome and, to a lesser extent, increased capacity to France. As a result of the traffic increase, Atlantic passenger load factor improved 1.4 percentage points. RASM increased 2 per cent reflecting the passenger load factor improvement.

Pacific passenger revenues were up $15 million or 7 per cent from the fourth quarter of 2004. Despite increased fuel surcharges to cover higher fuel costs, Pacific yield was essentially unchanged from the fourth quarter of 2004. Yield improvements in the Korea, China and Hong Kong markets were offset by lower yields in the Japan market reflecting an increased competitive pricing environment as a result of significant growth in capacity from both 6th Freedom and foreign carriers. The weakening of the Japanese yen against the stronger Canadian dollar compared to the fourth quarter of 2004 also had a significant negative impact on Pacific yields. Pacific passenger traffic grew 7 per cent on a 5 per cent increase in ASM capacity, primarily due to the recently introduced Toronto-Beijing route and an upgrade from a Boeing 767 to an Airbus A340 on the Toronto to Tokyo route. The passenger load factor improved 1.0 percentage point compared to the 2004 quarter. As a result of the improvement in the passenger load factor, RASM increased 2 per cent.

The South Pacific, Caribbean, Mexico and South America passenger revenues were up $15 million or 12 per cent from the fourth quarter of 2004. Traffic and ASM capacity both increased 8 per cent resulting in a passenger load factor unchanged from the 2004 quarter. Yield rose 5 per cent over the fourth quarter of 2004. RASM also increased 5 per cent as result of the yield improvement. The growth in these markets was largely from additional flying to South America, primarily capacity increases on Toronto-Sao Paulo and Toronto-Bogotá as well as increased frequency on Toronto-Santiago/Buenos Aires and, to a lesser extent, from increased service to traditional leisure destinations including the new Toronto-Santo Domingo route.

CARGO REVENUES

In 2005, the Corporation also provided cargo services from Toronto to key markets including Frankfurt, Shanghai and Los Angeles, using three chartered MD-11 all-cargo freighter aircraft. Two of the aircraft were added in 2005. The Frankfurt freighter operations commenced in November 2004, in order to replace cargo capacity following the earlier retirement of Boeing 747-400 Combi aircraft. The Shanghai freighter operations commenced in the spring of 2005.

Fourth quarter cargo revenues increased $25 million or 17 per cent and cargo traffic increased 16 per cent over 2004. This was mainly due to the addition of the two freighter aircraft in 2005 and greater cargo volumes notably in the Pacific market. Freighter revenues increased $29 million over the fourth quarter of 2004 and represented almost one quarter of cargo revenues in the 2005 quarter. Yield per revenue ton mile was one per cent higher than in the fourth quarter of 2004. The favourable yield impact of higher fuel surcharges was largely offset by the relative growth in lower-yielding long-haul freight traffic and the adverse effect of a stronger Canadian dollar on foreign currency denominated revenues.

OTHER REVENUES

Other non-transportation revenues were down $13 million or 6 per cent in the fourth quarter of 2005 largely as a result of lower third party engine maintenance revenues as well as a decrease in revenues from Air Canada Vacations due to the worst hurricane season on record which resulted in significantly lower passenger volumes, information technology system implementation challenges, as well as Air Canada Vacations' response to an aggressive competitive environment.

COST PERFORMANCE – FOURTH QUARTER 2005 VERSUS FOURTH QUARTER 2004

IMPACT OF THE ADOPTION OF ACG-15

Effective January 1, 2005, the Corporation adopted AcG-15. Refer to Note 2 to the 2005 Annual Consolidated Financial Statements for additional information on the adoption of AcG-15.

For the fourth quarter of 2005, the net impact of adopting AcG-15 on the Corporation's results was a before tax charge of $17 million or $0.17 per share, basic. The impact of the adoption of AcG-15 was a reduction to aircraft rent expense of $33 million, an increase to depreciation expense of $20 million, an increase to net interest expense of $19 million, a foreign exchange loss of $8 million and a non-controlling interest charge of $3 million compared to financial results had AcG-15 not been effective.

OPERATING EXPENSES

In the fourth quarter of 2005, total operating expenses increased $332 million or 16 per cent compared to the fourth quarter of 2004 and included a fuel expense increase of $146 million or 34 per cent. Unit cost rose 8 percent over the 2004 level. Excluding fuel expense, unit cost increased 4 per cent in the fourth quarter of 2005. Ownership costs, comprised of aircraft rent and depreciation, were significant factors in the increase in unit cost, excluding fuel. Ownership costs, as well as other costs, were affected by the addition of 41 new regional aircraft, such as the Embraer ERJ175/190 and the Bombardier CRJ705 aircraft, with higher unit costs but with lower trip costs, and two extra freighters in the 2005 quarter. These freighters incurred operating costs but produced no ASMs. Higher aircraft maintenance material and supplies expense was another significant negative factor.

Salaries and wages expense totaled $519 million in the fourth quarter of 2005, an increase of $42 million from the fourth quarter of 2004. Also included in salaries and wages expense in the fourth quarter of 2005 was approximately $40 million relating to employee profit sharing programs. Expenses of $2 million related to the profit sharing programs were recorded in 2004. Average full-time equivalent (FTE) employees increased 3 per cent on a capacity increase of 8 per cent over the 2004 quarter. The increase resulting from higher employee levels was partly offset by a reduction in average salaries reflecting employees being hired at lower wage scales. Employee productivity, as measured by ASM per FTE employee, grew 4 per cent over the fourth quarter of 2004.

Employee benefits expense amounted to $129 million in the fourth quarter of 2005, an increase of $10 million or 8 per cent from the fourth quarter of 2004, largely relating to revised pension actuarial estimates and to an adjustment in 2005 relating to an updated actuarial evaluation of workers' compensation liability.

On a capacity increase of 8 per cent, fuel expense was up $146 million or 34 per cent reflecting continuing record high fuel prices. The average base fuel price increase of $129 million and the volume-related increase of $42 million were partially offset by a reduction of $28 million due to the favourable impact of a stronger Canadian dollar versus the US dollar during the quarter when compared to the fourth quarter of 2004. Beginning in September 2005, the Corporation has implemented a systematic fuel risk management strategy and has entered into contracts with financial intermediaries to manage its exposure to jet fuel price volatility. A fuel hedging loss of $3 million relating to these contracts was recorded in the fourth quarter of 2005.
On a unit cost basis, fuel expense per ASM rose 24 per cent.

Aircraft rent expense increased $6 million or 5 per cent over the fourth quarter of 2004 mainly as a result of aircraft additions to the fleet largely offset by the impact of the adoption of AcG-15.

Airport and navigation fees rose $24 million or 12 per cent over the 2004 quarter. Higher landing and general terminal fees, primarily at Toronto's Lester B. Pearson (Pearson) International Airport, as well as an 8 per cent increase in aircraft departures versus the 2004 quarter were the main factors for the increase.

Aircraft maintenance, materials and supplies expense increased $26 million or 33 per cent. The increase was primarily related to the timing of engine maintenance activities and to the contracting out of heavy aircraft maintenance activities to outside maintenance, repair and overhaul (MRO) companies as ACTS, Air Canada and Jazz's primary MRO service provider, was operating at full capacity in the fourth quarter of 2005, and to the addition of Bombardier regional jet aircraft to the Jazz fleet. The increase was partly offset by the impact of the retirement of the BAe-146 aircraft fleet. The contracting out of maintenance activities to MRO companies resulted in increased aircraft maintenance, materials and supplies expense as all expenses (including labour) relating to the services purchased were included in this expense category.

Communications and information technology expense was up $7 million or 11 per cent largely due to an increase in information technology projects and also included a higher volume of communication services for web and Global Distribution System (GDS). The volume-related increases were partly 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 fourth quarter of 2004.

Food, beverage and supplies expense increased $5 million or 7 per cent versus the 2004 quarter on a passenger traffic increase of 9 per cent. The volume-related increase was largely offset by cost reduction initiatives and the impact of the new catering and buy-on-board programs. Additional expenses related to international service improvements were also a factor in the overrun.

Depreciation, amortization and obsolescence expense rose $40 million or 47 per cent largely due to the adoption of AcG-15 and as a result of a change in the estimated lives of certain aircraft.

Commission expense was down $18 million or 28 per cent on combined passenger and cargo revenue growth of 17 per cent. 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.

When compared to the fourth quarter of 2004, the other operating expense category was up $44 million or 12 per cent and included increases in credit card fees as a result of increased volume and average rates, legal and advisory fees, expenses related to the new uniform program and Aeroplan non-air redemption expenses. These increases were partly offset by lower advertising and promotion expense, reduced customer maintenance materials and lower expenses at Air Canada Vacations.

NON-OPERATING EXPENSE

Non-operating expense totaled $88 million in the fourth quarter of 2005, a $41 million increase from the fourth quarter of 2004. Net interest expense amounted to $62 million in the 2005 quarter, an increase of $15 million from the 2004 quarter, comprised primarily of higher interest expense of $19 million as a result of the adoption of AcG-15 partially offset by an increase of $8 million in interest income reflecting higher average interest rates. In the fourth quarter of 2005, loss on sale of and provision on assets of $30 million was recorded of which approximately $15 million related to the write-down of inactive Boeing 747 inventory.

FOREIGN EXCHANGE GAINS

Loss from revaluation of foreign currency monetary items amounted to $11 million in the fourth quarter of 2005 attributable to a weaker Canadian dollar versus the US dollar at December 31, 2005 compared to September 30, 2005. This loss included $5 million related to capital lease obligations and $8 million as a result of the adoption of AcG-15. In the fourth quarter of 2004, foreign exchange gains amounted to $78 million.

FUTURE INCOME TAXES

Recovery for income taxes amounted to $39 million in the fourth quarter of 2005 compared to a provision of $13 million recorded in the fourth quarter of 2004.

The comparison of fourth quarter financial results has been provided based on the consolidated results of ACE. Effective September 30, 2004, the Corporation's businesses are operated through four reportable segments: Transportation Services, Aeroplan, Jazz and ACTS. Refer to the Segment Information section of this MD&A for additional analysis of fourth quarter results for ACE's four reportable segments.

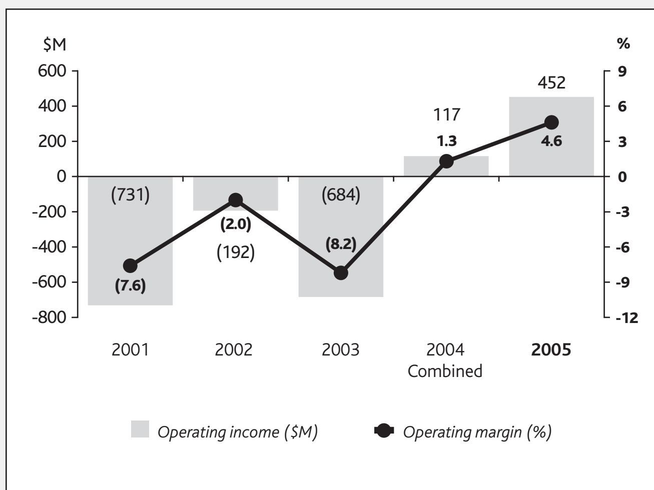
CONSOLIDATED RESULTS OF OPERATIONS - 2005 VERSUS 2004 COMBINED

PERFORMANCE AT A GLANCE

This section provides year-over-year comparisons for the years 2001 through to 2005 using Annual Supplementary Non-GAAP Combined Information for the year 2004, as defined on page 6 of this MD&A.

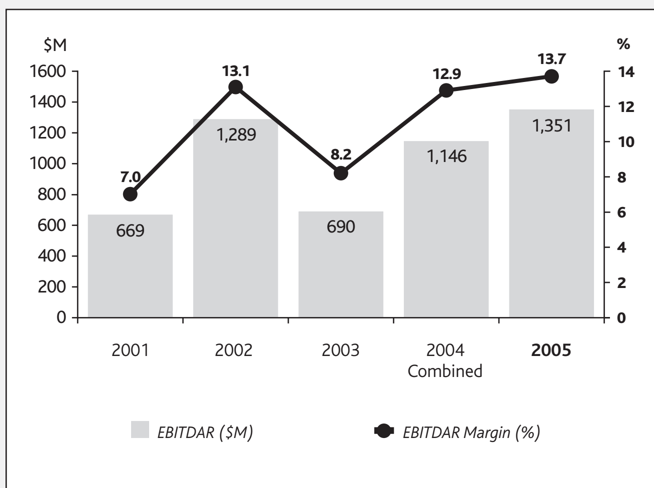
As a result of the inclusion of Aeroplan passenger revenues in passenger revenues starting in October 2004, as described on page 10 of this MD&A, year-over-year passenger revenue, RASM and yield information is not directly comparable to previous years. For comparative purposes, unless otherwise indicated, the following graphs and discussion will provide the reader with passenger revenue, RASM and yield changes that exclude the impact of the policy change related to Aeroplan passenger revenues. However, the graphs and discussion will also provide passenger revenue, RASM and yield changes that include the impact of the policy change related to Aeroplan passenger revenues.

Operating Income (loss) before reorganization and restructuring items and non-recurring labour expenses and Operating Margin



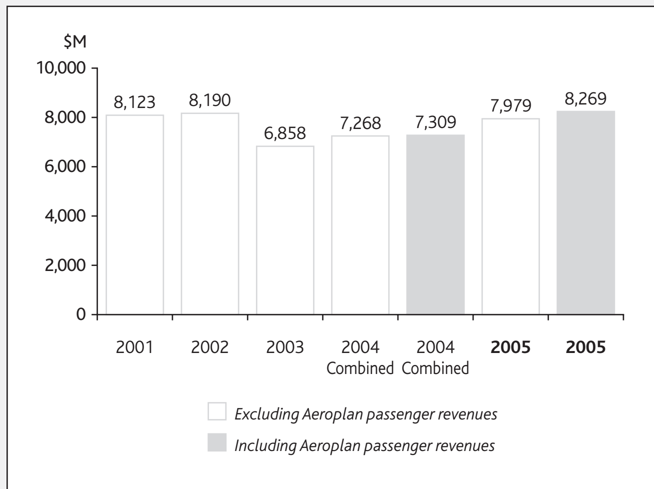
- Operating income of $452 million, a $335 million improvement from the 2004 Combined operating income, before reorganization and restructuring items, of $117 million.
- Operating revenues increased $930 million or 10 per cent over 2004 Combined, mainly reflecting passenger revenue increases in all markets and including the transfer of Aeroplan passenger revenues to the Passenger revenue category beginning in October 2004.
- Operating expenses up $595 million or 7 per cent versus 2004 Combined, including a $592 million or 37 per cent increase in fuel expense.
- Unit cost, as measured by operating expense per ASM, up 3 per cent over 2004 Combined.
- Excluding fuel expense, unit cost down 4 per cent, in part reflecting the impact of fresh start reporting.

EBITDAR, before reorganization and restructuring items and non-recurring labour expenses



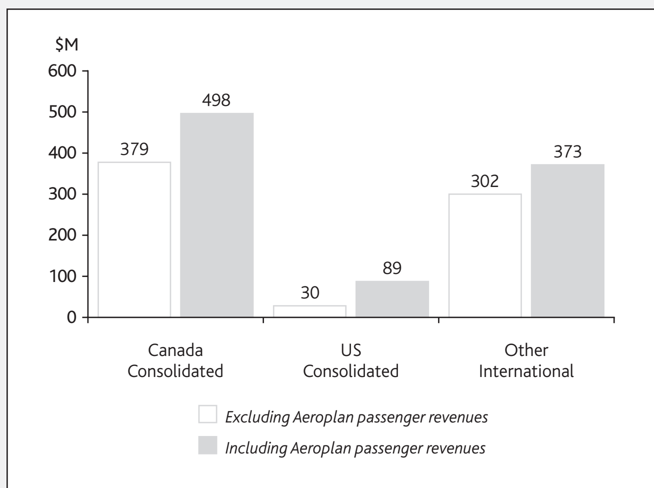
- EBITDAR increased $205 million in 2005 to $1,351 million despite an increase in fuel expense of $592 million or 37 per cent over 2004 Combined.
- EBITDAR margin rose 0.8 percentage points over 2004 Combined. Refer to "Non-GAAP Financial Measures" on page 8 of this MD&A for additional information on EBITDAR.

Passenger Revenue Change



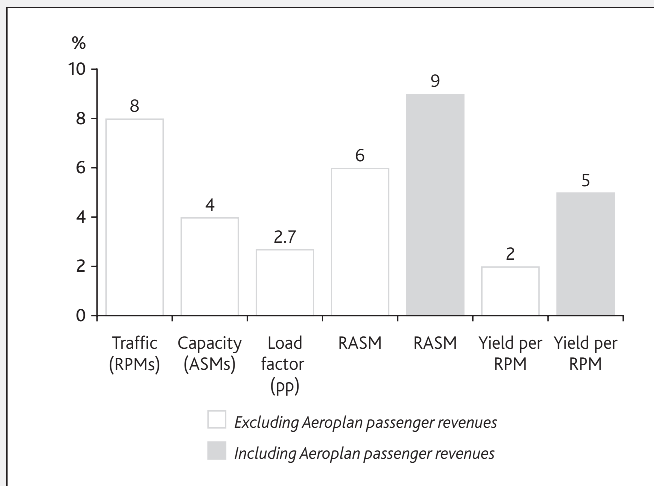
- In 2005, passenger revenues, including Aeroplan passenger revenues, increased $960 million or 13 per cent reflecting increases in all markets and including the transfer of Aeroplan passenger revenues in the Passenger revenue category beginning in October 2004.

Passenger Revenue $M Change by Service 2005 versus 2004 Combined



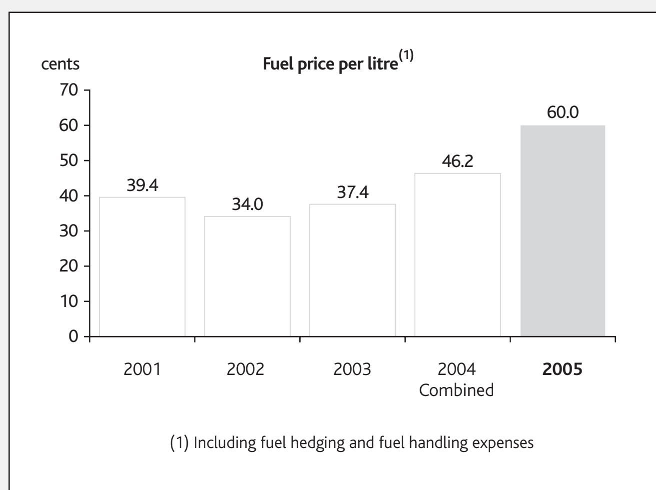
- Canada passenger revenues, including Aeroplan passenger revenues, showed considerable growth over 2004 Combined, rising $498 million or 17 per cent.
- US transborder passenger revenues, including Aeroplan passenger revenues, were up $89 million or 6 per cent.
- Other international revenues, including Aeroplan passenger revenues, increased $373 million or 13 per cent.

Passenger Revenues and Statistics % change 2005 versus 2004 Combined



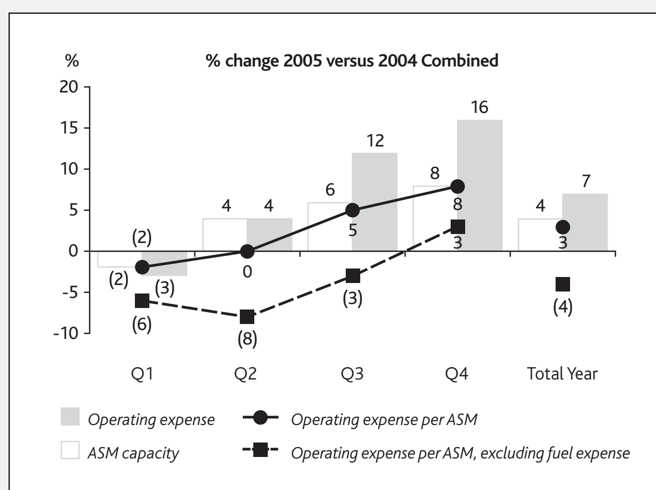
- RASM, including Aeroplan passenger revenues, improved 9 per cent year-over-year due to both a 2.7 percentage point improvement in passenger load factor and a yield increase of 5 per cent.
- 2005 system traffic was up 8 per cent on a 4 per cent increase in ASM capacity.

Aircraft Fuel Expense



- With record high fuel prices, aircraft fuel expense was up $592 million or 37 per cent on a capacity increase of 4 per cent from 2004 Combined.
- The average base fuel price increase of $659 million and the volume-related increase of $89 million were partly offset by a decrease of $159 million as a result of the favourable impact of a stronger Canadian dollar.
- Average fuel price per litre rose 30 per cent over 2004 Combined.
- In 2005, the average price per litre was 60 cents with an average West Texas Intermediate (WTI) crude oil price per barrel of US$55 compared to an average price per litre of 46 cents with an average WTI crude oil price per barrel of US$40.

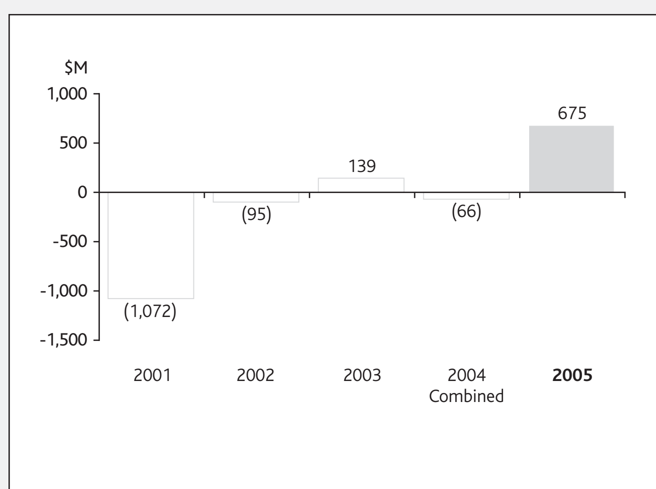
Operating Cost Performance
Changes in Operating Expense, ASM Capacity, Unit Cost (1) and Unit Cost, excluding fuel expense (2)



- For the full year 2005, unit cost was up 3 per cent over 2004 Combined.
- Excluding fuel expense, unit cost in 2005 was down 4 per cent.
- ASM capacity increased 4 per cent in 2005 versus 2004 Combined.

(1) Unit cost is calculated as operating expense divided by ASMs.
(2) Unit cost, excluding fuel expense, is calculated as operating expense, removing fuel expense, divided by ASMs.

Cash Flows from (used for) Operations



- Cash flows from operations amounted to $675 million in 2005, compared to cash flows used for operations of $66 million in 2004 Combined.
- 2004 Combined cash flows used for operations included $314 million of net payments made on September 30, 2004. These payments related mainly to settlement of restructuring obligations.

COMPARISON OF RESULTS – 2005 VERSUS 2004 COMBINED

The following table compares the 2005 Consolidated Statement of Operations of ACE, the 2004 Combined Statement of Operations as defined on page 6 of this MD&A under "Non-GAAP Financial Measures", and the 2003 Consolidated Statement of Operations of the Predecessor Company.

Consolidated Statement of Operations ($ millions, except per share figures)	ACE 2005	Combined 2004	Air Canada 2003	% Change 2005 versus 2004	% Change 2005 versus 2003
Operating revenues					
Passenger	8,269	7,309	6,858	13	21
Cargo	620	556	519	12	19
Other	941	1,035	996	(9)	(6)
	9,830	8,900	8,373	10	17
Operating expenses					
Salaries, wages and benefits	2,520	2,585	2,828	(3)	(11)
Aircraft fuel	2,198	1,606	1,253	37	75
Aircraft rent	417	632	1,008	(34)	(59)
Airport and navigation fees	924	814	743	14	24
Aircraft maintenance, materials and supplies	367	343	385	7	(5)
Communications and information technology	303	302	390	0	(22)
Food, beverages and supplies	334	340	334	(2)	0
Depreciation, amortization and obsolescence	482	397	366	21	32
Commissions	253	305	273	(17)	(7)
Other	1,580	1,459	1,477	8	7
	9,378	8,783	9,057	7	4
Operating income (loss) before reorganization and restructuring items	**452**	**117**	**(684)**		
Reorganization and restructuring items	-	(871)	(1,050)		
Non-operating income (expense)					
Aeroplan dilution gain	190	-	-		
Interest income	66	17	25		
Interest expense	(315)	(229)	(115)		
Interest capitalized	14	2	4		
Loss on sale of and provisions on assets	(28)	(75)	(168)		
Other	(12)	(8)	(28)		
	(85)	(293)	(282)		
Income (loss) before the following items:	367	(1,047)	(2,016)		
Non-controlling interest	(24)	-	-		
Foreign exchange gain	46	182	137		
Recovery of (provision for) income taxes	(131)	(15)	12		
Income (loss) for the period	258	(880)	(1,867)		
Earnings (loss) per share [1]					
- Basic	2.63	nm	($15.53)		
- Diluted	2.46	nm	($15.53)		
EBITDAR [2]	1,351	1,146	690		

(1) Pursuant to the Plan as further described in Note 19 to the 2005 Annual Consolidated Financial Statements, all issued and outstanding options of Air Canada and warrants were cancelled without payment or consideration on September 30, 2004. In addition, a new ACE share capital structure was established, as further described in Note 12 to the 2005 Annual Consolidated Financial Statements.

(2) Refer to "Non-GAAP Financial Measures" on page 8 of this MD&A for a reconciliation of EBITDAR for the years 2004 and 2005. 2003 EBITDAR of $690 million is reconciled to operating income (loss) before reorganization and restructuring items, as follows: GAAP operating income before reorganization and restructuring items of ($684) million, adding back aircraft rent of $1,008 million and depreciation, amortization and obsolescence of $366 million.

Operating Statistics	ACE 2005	Combined 2004	Predecessor company 2003	% Change 2005 versus 2004	% Change 2005 versus 2003
Revenue Passenger Miles (millions)	46,764	43,427	39,565	8	18
Available Seat Miles (millions)	58,822	56,536	54,160	4	9
Passenger Load Factor (%)	79.5	76.8	73.1	2.7 pp	6.4 pp

For the full year 2005, in spite of a fuel expense increase of $592 million or 37 per cent, ACE reported operating income of $452 million, an improvement of $335 million over the same period in 2004. EBITDAR improved $205 million over 2004 Combined. Refer to "Non-GAAP Financial Measures" on page 8 of this MD&A for additional information on EBITDAR.

In 2005, total operating revenues increased $930 million or 10 per cent compared to 2004 Combined. Passenger revenues were up $960 million or 13 per cent reflecting increases in all markets and including the transfer of Aeroplan passenger revenues into the Passenger revenue category starting in October 2004. Prior to October 2004, Aeroplan passenger revenues were recorded in the Other revenue category. In addition, to cover higher fuel costs, domestic and US transborder fare levels have been increased in 2005 and fuel surcharges have been significantly increased to and from most international destinations.

Operating expenses were up $595 million versus 2004 Combined and included an increase in fuel expense of $592 million or 37 per cent from 2005. ASM capacity increased 4 per cent compared to 2004 Combined. Unit cost for 2005, as measured by operating expense per ASM, rose 3 per cent from 2004 Combined. Excluding fuel expense, unit cost in 2005 was down 4 per cent. Unit cost reductions included aircraft rent, benefits expense, commissions, salaries and wages expense and food, beverages and supplies.

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.

In 2005, non-operating expense decreased $208 million and included a dilution gain of $190 million (before tax) as a result of the dilution of the Corporation's interest in Aeroplan relating to the Aeroplan transaction which was completed in the Second Quarter of 2005 and is further described in Note 13 to the 2005 Annual Consolidated Financial Statements.

In 2005, gains from revaluation of foreign currency monetary items amounted to $46 million attributable to a stronger Canadian dollar versus the US dollar at December 31, 2005 compared to December 31, 2004. In 2004 Combined, foreign exchange gains on non-compromised monetary items totaled $182 million.

A provision for income taxes of $131 million was recorded in 2005, $28 million of which related to the Aeroplan transaction which took place in the second quarter of 2005. No tax recovery was recorded on the loss for the first nine months of 2004. The provision for income taxes in 2004 Combined amounted to $15 million.

Net income in 2005 was $258 million compared to a net loss of $880 million in 2004 Combined, an improvement of $1,138 million.

REVENUE PERFORMANCE – 2005 VERSUS 2004 COMBINED

PASSENGER REVENUES

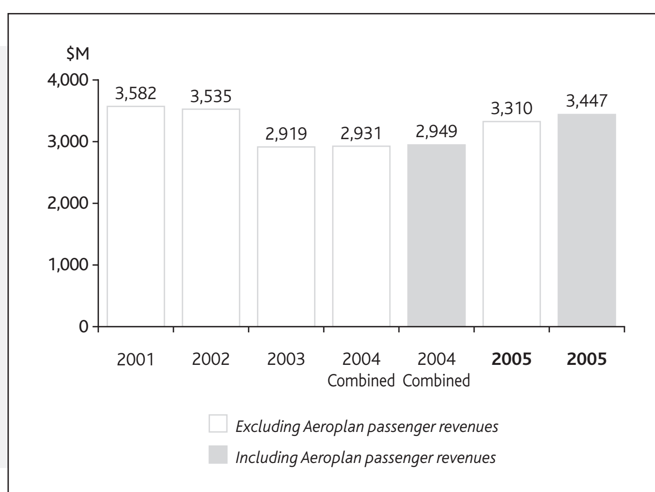
The table below describes, by major market, excluding the impact of the policy change related to Aeroplan passenger revenues, year-over-year percentage changes in passenger revenues, capacity as measured by ASMs, traffic as measured by RPMs, passenger load factor as measured by RPMs divided by ASMs, yield as measured by passenger revenue per RPM, and RASM as measured by passenger revenue per ASM.

Operating Statistics 2005 versus 2004 Combined	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield per RPM % Change	RASM % Change
Canada	13	4	8	3.2	5	9
US	2	(4)	5	6.0	(3)	6
Atlantic	10	6	9	1.9	1	4
Pacific	8	6	6	(0.4)	3	2
Other	16	12	14	1.4	2	4
System (excluding Aeroplan)	10	4	8	2.7	2	6
System (including Aeroplan)	13	4	8	2.7	5	9

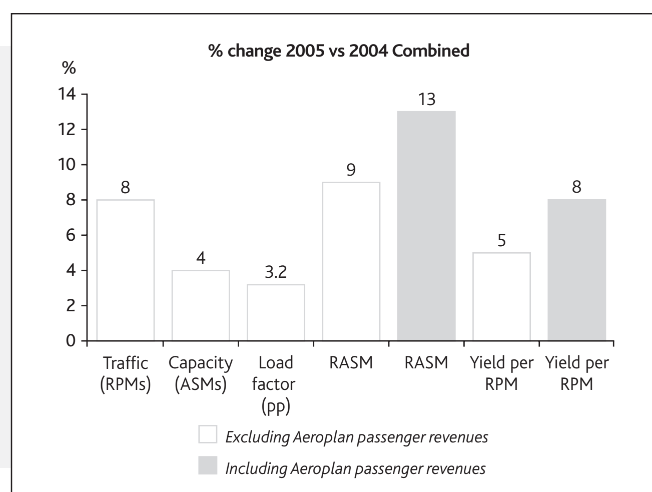
As compared to 2004 Combined, system passenger revenues, which included Aeroplan passenger revenues of $290 million for the full year 2005 and $41 million for the fourth quarter of 2004, were up $960 million or 13 per cent.

In 2005, system passenger traffic rose 8 per cent on a 4 per cent increase in ASM flying capacity producing a 2.7 percentage point improvement in passenger load factor versus the 2004 Combined level. Increases in yield for the domestic and other international markets were partly offset by a decline in yield in the US transborder market, reflecting an extremely competitive US transborder market and a weaker US dollar which lowers the Canadian dollar value of revenues from the US. To partially offset the large spike in fuel prices, domestic fares were increased significantly in 2005, while fuel surcharges were added on international routes. System RASM, excluding Aeroplan passenger revenues, rose 6 per cent in 2005, mainly reflecting both the improvement in passenger load factor and the increase in system yield.

Domestic Passenger Revenues

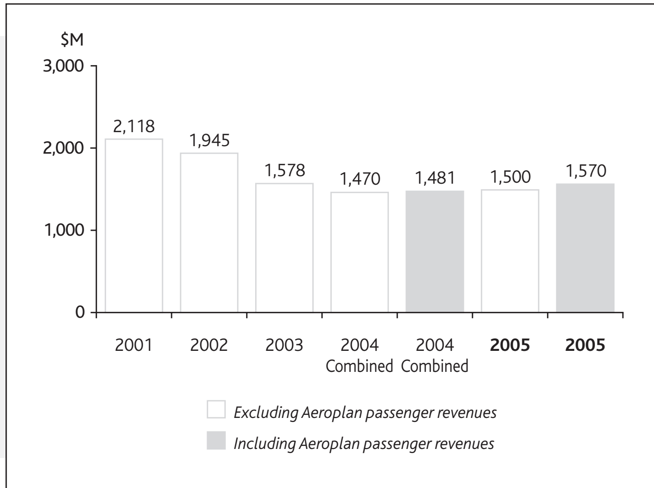


Components of Domestic Passenger Revenues

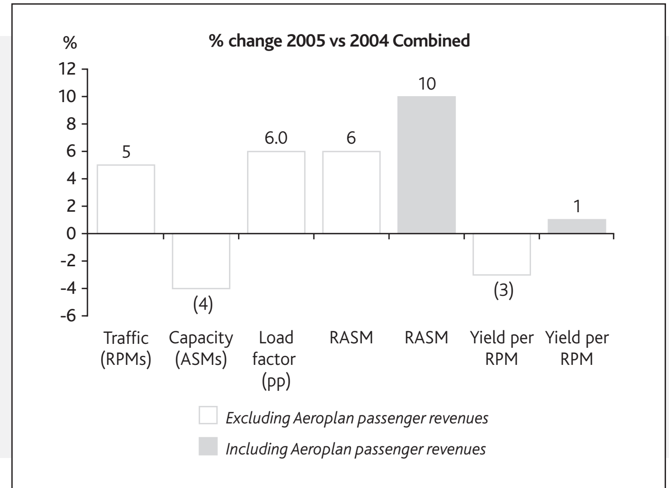


In 2005, domestic passenger revenues, which included Aeroplan passenger revenues of $137 million for the full year 2005 and $18 million for the fourth quarter of 2004, were up $498 million or 17 per cent from 2004 Combined. Domestic passenger traffic grew 8 per cent on an ASM capacity increase of 4 per cent resulting in a passenger load factor improvement of 3.2 percentage points over the 2004 Combined level. Domestic yield increased 5 per cent in 2005, excluding Aeroplan passenger revenues, mainly due to increased fare levels to cover higher fuel costs, an improved domestic competitive position, as well as a stronger market for the higher priced Tango Plus product. Reflecting both the improvement in passenger load factor and the increase in yield, excluding Aeroplan passenger revenues, domestic RASM rose 9 per cent above 2004 Combined.

US Transborder Passenger Revenues

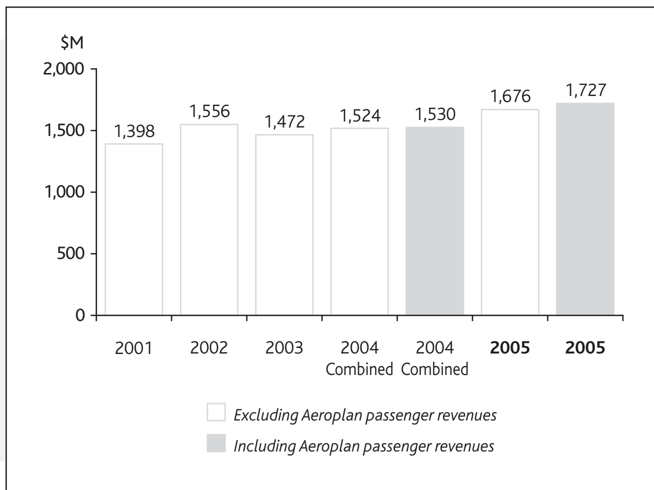


Components of US Transborder Passenger Revenues

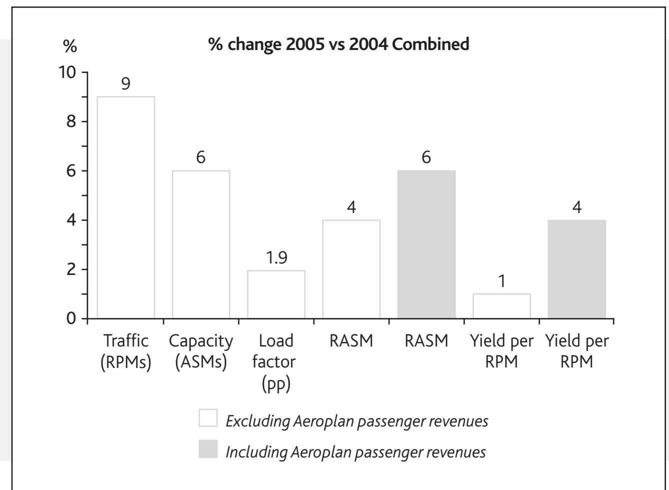


US transborder passenger revenues, which included Aeroplan passenger revenues of $70 million for the full year 2005 and $11 million for the fourth quarter of 2004, increased $89 million or 6 per cent from the 2004 Combined level. In response to increased capacity from US carriers, US transborder ASM capacity was reduced by 4 per cent. In spite of the ASM capacity reduction, traffic increased 5 per cent resulting in a passenger load factor improvement of 6.0 percentage points. Excluding Aeroplan passenger revenues, yield declined 3 per cent reflecting the weakening of the US dollar for sales denominated in US dollars as well as an aggressive pricing environment resulting from increased capacity in the US transborder market by Canadian low-cost carriers. Excluding Aeroplan passenger revenues, US transborder RASM was up 6 per cent as the large improvement in passenger load factor more than offset the yield decrease.

Atlantic Passenger Revenues

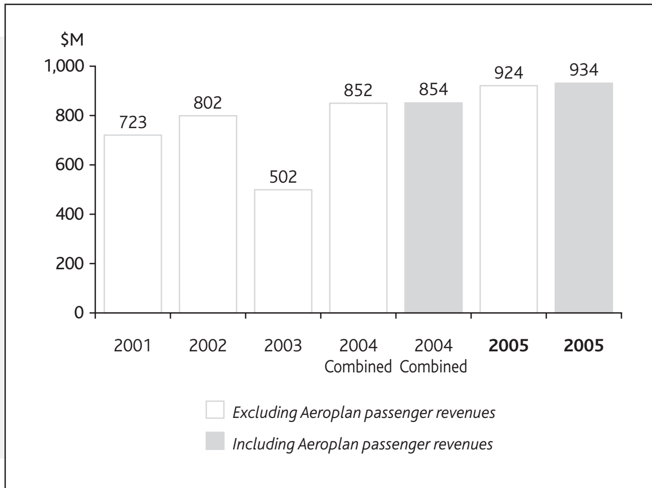


Components of Atlantic Passenger Revenues

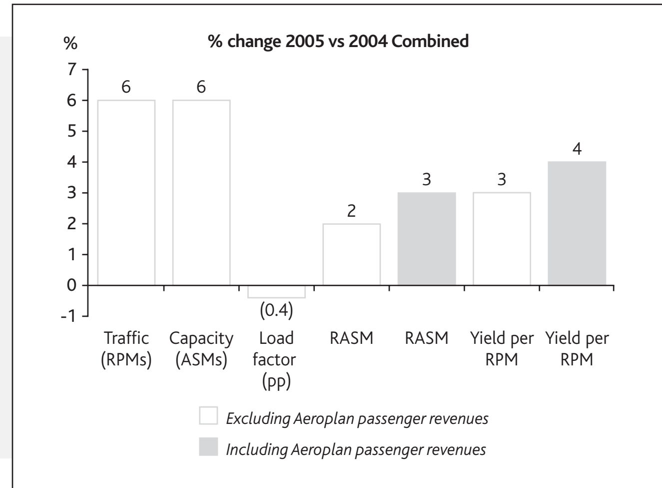


Atlantic passenger revenues, which included Aeroplan passenger revenues of $51 million for the full year 2005 and $6 million for the fourth quarter of 2004, increased $197 million or 13 per cent in 2005 from the 2004 Combined level. Despite the increase in fuel surcharges to cover higher fuel costs, yield only increased 1 per cent, excluding Aeroplan passenger revenues, reflecting a significant weakening of currencies for sales denominated in Euro and Sterling Pound as well as a competitive pricing environment due to growth in charter capacity to Europe and the United Kingdom. Atlantic traffic grew 9 per cent reflecting a strong market demand in the United Kingdom and France markets, as well as the addition of the route to Rome, Italy. Capacity was increased 6 percent largely due to the addition of the Rome route and additional frequencies to the United Kingdom, France and Switzerland. Excluding Aeroplan passenger revenues, RASM was up 4 per cent reflecting the improvement in the passenger load factor and, to a much lesser extent, the yield increase.

Pacific Passenger Revenues

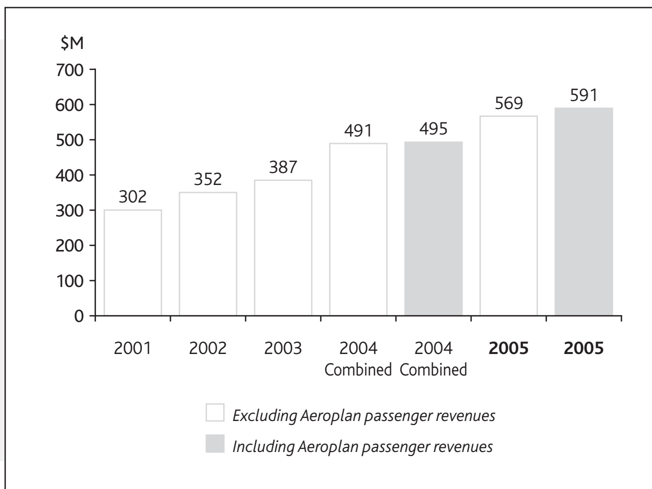


Components of Pacific Passenger Revenues

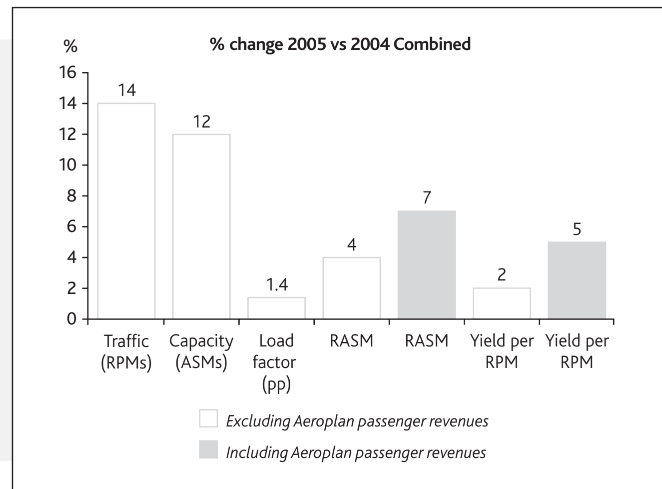


Pacific passenger revenues, which included Aeroplan passenger revenues of $10 million for the full year 2005 and $2 million for the fourth quarter of 2004, were up $80 million or 9 per cent versus 2004 Combined. Excluding Aeroplan passenger revenues, yield improved 3 per cent from the 2004 Combined level due to increased fuel surcharges in 2005 to cover higher fuel costs as well as yield improvements in the Hong Kong and Korea markets due to an increased proportion of higher-yielding business travelers. Pacific traffic and ASM capacity both rose 6 per cent resulting in a passenger load factor essentially unchanged from 2004 Combined. Capacity increases were mostly reflected in the China market, which saw the introduction of non-stop Toronto-Beijing and Toronto-Seoul services. Excluding Aeroplan passenger revenues, RASM rose 2 per cent as a result of the yield increase, despite a negative currency impact caused by the stronger Canadian dollar versus the Japanese yen.

Other Passenger Revenues



Components of Other Passenger Revenues

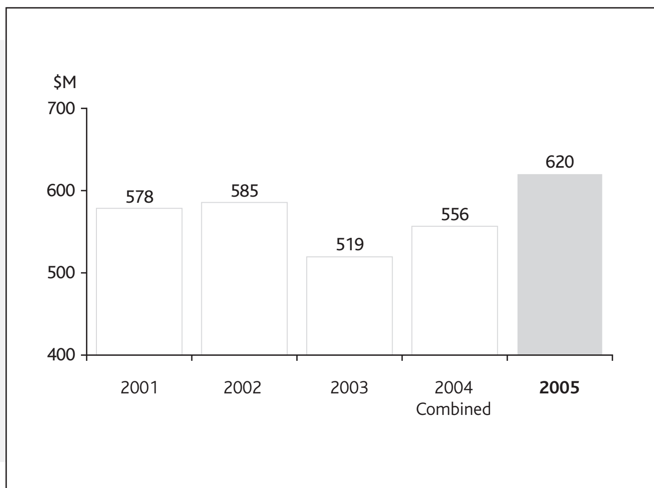


South Pacific, Caribbean, Mexico and South America (Other) passenger revenues, which included Aeroplan passenger revenues of $22 million for the full year 2005 and $4 million for the fourth quarter of 2004, increased $96 million or 19 per cent in 2005. Traffic grew 14 per cent on an ASM capacity increase of 12 per cent resulting in a 1.4 percentage point improvement in passenger load factor compared to the 2004 Combined level. Excluding Aeroplan passenger revenues, yield was up 2 per cent over 2004 Combined in part due to increased fuel surcharges to cover higher fuel costs. RASM increased 4 per cent reflecting both the passenger load factor improvement and, to a lesser extent, the yield increase. The growth in these markets was largely from additional flying to South America, including Lima, Caracas and Bogotá.

CARGO REVENUES

Cargo revenues increased $64 million or 12 per cent mainly due to the addition of two freighter aircraft in 2005 and greater cargo volumes notably in the Pacific market. With the introduction of Shanghai and the full year effect of Frankfurt freighter operations, freighter revenues increased $98 million over 2004. This was partially offset by lower non-freighter revenues due to the retirement of the Boeing 747-400 Combi aircraft in late 2004. Yield per revenue ton mile was essentially unchanged from the 2004 Combined level. The favourable yield impact of increased fuel surcharges in 2005 was largely offset by the relative growth in lower-yielding long-haul freight traffic and unfavourable foreign exchange versus 2004 Combined.

Cargo Revenues



OTHER REVENUES

Non-transportation revenues were down $94 million or 9 per cent mainly as a result of the change in accounting policy for the loyalty program (Aeroplan) effective October 1, 2004, as described on page 10 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 fourth quarter of 2004 and the full year 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 was an increase in cancellation and change fees, higher third party maintenance revenues and various other increases.

COST PERFORMANCE – 2005 VERSUS 2004 COMBINED

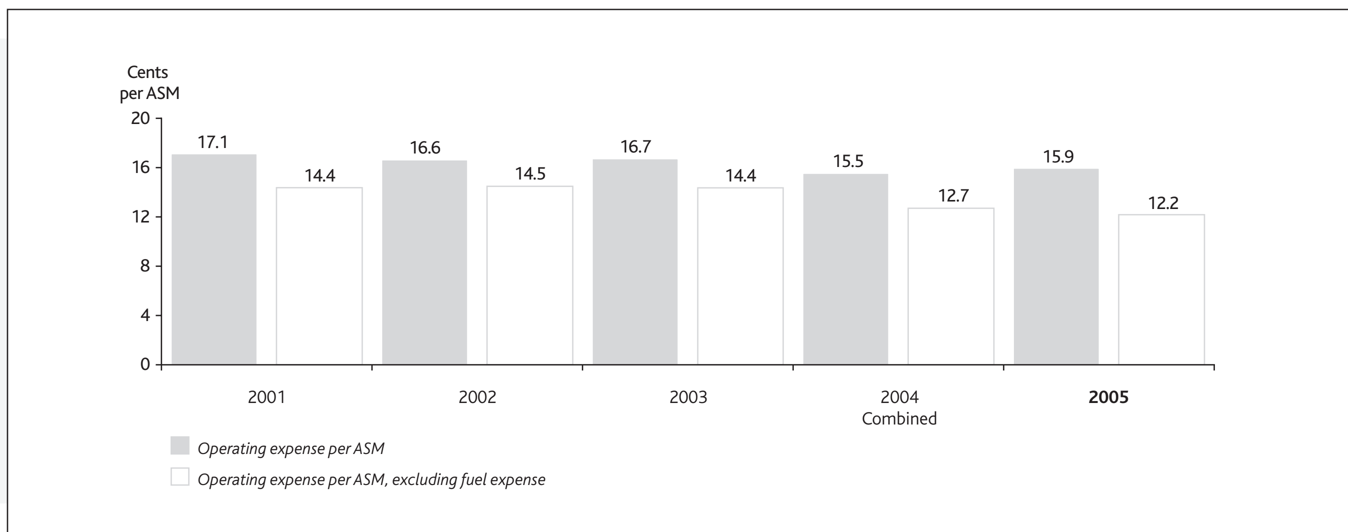
IMPACT OF THE ADOPTION OF ACG-15

For the full year 2005, the net impact of adopting AcG-15 on the Corporation's results was a pre-tax charge of $42 million or $0.43 per share, basic. The impact of the adoption of AcG-15 was a reduction to aircraft rent expense of $120 million, an increase to depreciation expense of $86 million, an increase to net interest expense of $88 million, a foreign exchange gain of $26 million and a non-controlling interest charge of $14 million compared to financial results had AcG-15 not been effective.

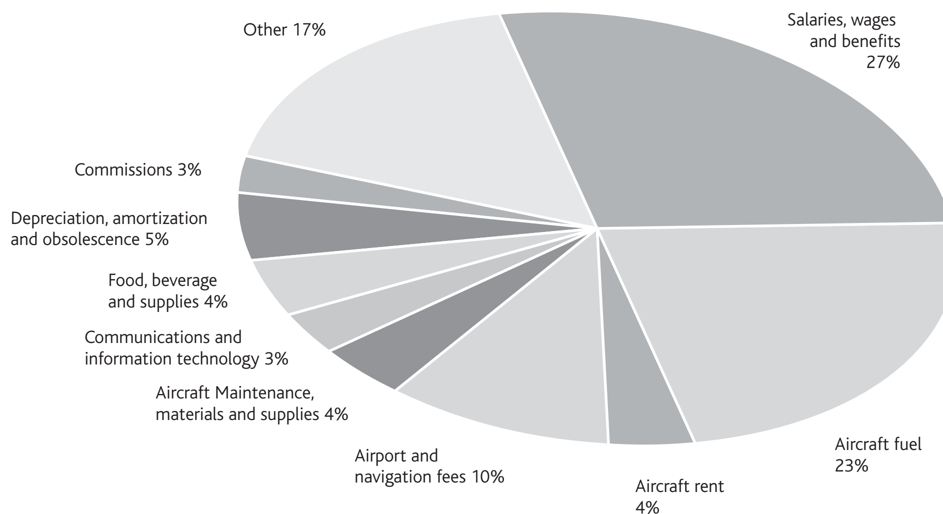
OPERATING EXPENSES

For the full year 2005, operating expenses increased $595 million or 7 per cent compared to 2004 Combined and included a fuel expense increase of $592 million or 37 per cent. Unit cost increased 3 per cent versus the 2004 Combined level. Excluding fuel expense, unit cost declined 4 per cent in 2005.

Unit Cost



2005 Operating Expenses
% of total



The following discussion summarizes those categories with significant year-over-year variances:

Salaries and wage expense totaled $1,978 million in 2005, an increase of $43 million or 2 per cent from the 2004 Combined level. Included in salaries and wages were expenses relating to employee profit sharing programs in 2005. The average number of full-time equivalent (FTE) employees in 2005 was essentially unchanged from 2004 Combined. Employee productivity, as measured by ASM per FTE employee, grew 4 per cent compared to the 2004 Combined level.

Employee benefits expense amounted to $542 million in 2005, a decrease of $108 million or 17 per cent from 2004 Combined. 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 $592 million or 37 per cent, on a capacity increase of 4 per cent, reflecting continuing record high fuel prices. The average base fuel price increase of $659 million and the volume-related increase of $89 million were partially offset by a reduction of $159 million due to the favourable impact of a stronger Canadian dollar versus the US dollar during the year. Beginning in September 2005, the Corporation has implemented a systematic fuel risk management strategy and has entered into contracts with financial intermediaries to manage its exposure to jet fuel price volatility. A fuel hedging loss of $3 million relating to these contracts was recorded in the fourth quarter of 2005. Prior to these derivative instruments being designated as hedges for accounting purposes, an unrealized gain of $2 million was recorded in other non-operating expense. On a unit cost basis, fuel expense per ASM rose 32 per cent.

Aircraft rent expense was down $215 million or 34 per cent versus 2004 Combined largely due to the adoption of AcG-15, the impact of fair value adjustments as a result of fresh start reporting, the termination of Boeing 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 2004 Combined. These decreases were partly offset by aircraft additions to the fleet, net of aircraft returns or terminations.

Airport and navigation fees increased $110 million or 14 per cent on a 1 per cent increase in aircraft departures. Higher landing and general terminal fees, primarily at Toronto's Pearson International Airport, and 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, 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) overflight fees.

Aircraft maintenance, materials and supplies expense increased $24 million or 7 per cent. The increase is mainly due to the timing of engine maintenance activities, to the contracting out of heavy aircraft maintenance activities to outside maintenance, repair and overhaul (MRO) companies as ACTS, Air Canada and Jazz's primary MRO service provider, was operating at full capacity, and to the addition of Bombardier regional jet aircraft to the Jazz fleet. This increase was partly offset by the impact of the retirement of the BAe 146 aircraft fleet. The contracting out of maintenance activities to MRO companies resulted in increased aircraft maintenance, materials and supplies expense as all expenses (including labour) relating to the services purchased were included in this expense category.

Communications and information technology expense increased $1 million from the 2004 level. Increased volume for communication services for web and Global Distribution System (GDS) as well as an increase in information technology projects were offset by renegotiated contract rates for information technology and communications services and by the impact of a stronger Canadian dollar versus the US dollar when compared to 2004 Combined.

Food, beverage and supplies expense decreased $6 million or 2 per cent versus the 2004 Combined level on a passenger traffic increase of 8 per cent. The impact of the cost reduction initiatives and the new catering and buy-on-board programs implemented by the Corporation more than offset the volume-related and the international service improvement increases.

When compared to 2004 Combined, depreciation, amortization and obsolescence expense was up $85 million or 21 per cent in 2005 largely related to the adoption of AcG-15.

In 2005, commission expense was down $52 million or 17 per cent on combined passenger and cargo revenue growth of 10 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 $121 million or 8 per cent over the 2004 Combined level and included increases in credit card fees, advisory fees, customer inconvenience and baggage mishandling expenses, Aeroplan non-air redemption expenses, a higher volume and an increase in the cost of tour packages by Air Canada Vacations, as well as other categories of expenses mainly related to the 4 per cent growth in capacity. These increases were partly offset by a reduction in advertising and promotion expense and reductions in other categories.

NON-OPERATING EXPENSE

Non-operating expense amounted to $85 million in 2005, a $208 million decrease over 2004 Combined. In the second quarter of 2005, ACE recorded a dilution gain of $190 million (before tax) as a result of the dilution of its interest in Aeroplan. Net interest expense amounted to $235 million in 2005, an increase of $25 million from 2004 Combined. Interest expense rose $86 million and included the impact of the adoption of AcG-15 of $88 million. Interest income totaled $66 million in 2005, up $49 million from the 2004 Combined level primarily related to higher cash balances and an increase in average interest rates. In addition, in 2004 Combined, prior to emergence from CCAA on September 30, 2004, interest income of $17 million was allocated to reorganization and restructuring items. Included in other non-operating expenses in 2005 was a charge of $29 million relating to the repayment of the GE exit credit facility and income of $17 million related to a settlement of interest rate swaps on aircraft leases.

In 2005, loss on sale of and provision on assets of $28 million was recorded of which approximately $15 million related to the write-down of inactive Boeing 747 inventory. In 2004 Combined, the Corporation recorded provisions of $75 million relating mainly to non-operating aircraft, including $18 million for spare parts.

FOREIGN EXCHANGE

Gains from revaluation of foreign currency monetary items amounted to $46 million in 2005 attributable to a stronger Canadian dollar versus the US dollar at December 31, 2005 compared to December 31, 2004. The foreign exchange gains recorded in 2005 included gains of $40 million related to capital lease obligations and $26 million resulting from the adoption of AcG-15. This compared to foreign exchange gains on non-compromised monetary items of $182 million recorded in 2004 Combined.

FUTURE INCOME TAXES

Provision for income taxes totaled $131 million in 2005, of which $28 million related to the Aeroplan transaction which took place in the second quarter of 2005. The Corporation recorded a provision for income taxes of $15 million in 2004 Combined. No tax recovery was recorded on the loss in 2004 in the Predecessor Company. Refer to Note 8 to the 2005 Annual Consolidated Financial Statements of ACE for additional information on future income taxes.

THE STATEMENT OF FINANCIAL POSITION AND LIQUIDITY

The consolidated statements of financial position as at December 31, 2005 and December 31, 2004 represent the accounts of ACE and its subsidiaries on a post-emergence fresh start reporting basis, as further described in Notes 2 and 20 to the 2005 Annual Consolidated Financial Statements. The consolidated statement of financial position as of December 31, 2003 represents the accounts of the Predecessor Company. In accordance with CICA 1625, prior period financial information has not been restated to reflect the impact of fair value adjustments and, accordingly, amounts in the Predecessor Company are not directly comparable.

Condensed Consolidated Statement of Financial Position ($ millions)	ACE At December 31, 2005	ACE At December 31, 2004	Predecessor Company At December 31, 2003
ASSETS			
Current			
Cash, cash equivalents and short-term investments	2,181	1,632	670
Other current assets	1,173	1,063	1,041
	3,354	2,695	1,711
Property and equipment	5,494	3,684	1,700
Deferred charges	145	167	2,340
Goodwill	-	-	510
Intangible assets	2,462	2,703	164
Other assets	392	137	485
	11,847	9,386	6,910
LIABILITIES			
Current liabilities	3,011	2,616	2,402
Long-term debt and capital lease obligations	3,543	2,328	332
Convertible preferred shares	148	132	-
Future income taxes	221	243	11
Pension and other benefit liabilities	2,154	2,344	964
Non-controlling interest	203	-	-
Deferred credits	-	-	827
Other long-term liabilities	1,399	1,520	1,216
	10,679	9,183	5,752
Liabilities subject to compromise	-	-	5,313
	10,679	9,183	11,065
SHAREHOLDERS' EQUITY			
Share capital and other equity	747	187	967
Contributed surplus	6	1	25
Retained earnings	415	15	(5,147)
	1,168	203	(4,155)
	11,847	9,386	6,910

As a result of the adoption of AcG-15 effective January 1, 2005, Air Canada consolidated the financial statements of certain aircraft and engine leasing entities and fuel facilities corporations. As at December 31, 2005, additional property and equipment of $1,333 million, long-term debt, including current portion, of $1,178 million, other assets of $112 million, and non-controlling interest of $203 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 in Note 2 to the 2005 Annual Consolidated Financial Statements of ACE.

SHARE CAPITAL AND OTHER EQUITY

At December 31, 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:

	Authorized	ACE At December 31, 2005 Outstanding (000)	ACE At December 31, 2004 Outstanding (000)
Issued and outstanding common shares			
Class A variable voting shares	Unlimited	76,735	74,813
Class B voting shares	Unlimited	25,059	8,813
Shares held in escrow		28	5,189
Total issued and outstanding common shares		**101,822**	**88,815**

	ACE At December 31, 2005 Outstanding (000)	ACE At December 31, 2004 Outstanding (000)
Common shares potentially issuable		
Convertible preferred shares	10,228	9,375
Convertible notes	6,875	-
Stock options	3,187	3,028
Total common shares potentially issuable	**20,290**	**12,403**

Share Capital and Other Equity Summary (net of issue costs): ($ millions)	ACE At December 31, 2005	ACE At December 31, 2004
Common shares	$ 2,231	$ 1,778
Convertible preferred shares	117	117
Convertible notes	92	-
	2,440	**1,895**
Adjustment to shareholders' equity (1)	(1,693)	(1,708)
Share capital and other equity	**$ 747**	**$ 187**

(1) Under fresh start reporting, the balance in shareholders' equity after a comprehensive revaluation is adjusted to the net value of identifiable assets and liabilities. CICA 1625 - Comprehensive Revaluation of Assets and Liabilities, does not permit goodwill to be recorded even if the fair value of net assets is less than the fair value of the enterprise as a whole.

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, ACE issued $330 million of 4.25 per cent 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.

The Corporation 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 27,927 shares that continue to be held in escrow by the Monitor pending resolution of tax obligations with governmental authorities.

LIQUIDITY AND WORKING CAPITAL

At December 31, 2005, the Corporation had cash, cash equivalents and short-term investments of $2,181 million and positive working capital of $343 million. At December 31, 2004, the Corporation had cash, cash equivalents and short-term investments of $1,632 million and positive working capital of $79 million.

AIR CANADA

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. At December 31, 2005, no amount was drawn under this facility. The credit facility is secured, principally, 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.

AEROPLAN

During 2005, Aeroplan 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 thereof) term facility (Term A Facility), a $100 million (or the U.S. dollar equivalent thereof) acquisition facility (Term B Facility) and a $75 million (or the U.S. dollar equivalent thereof) revolving term credit facility. The Term A Facility was drawn on June 29, 2005 in the amount of $300 million, in order to fund a portion of the $400 million Aeroplan miles redemption reserve. Refer to Note 13 to the 2005 Annual Consolidated Financial Statements for additional information. The Term B Facility is 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, and was repaid during the third quarter of 2005. At December 31, 2005, there were no amounts drawn under the Term B facility. Refer to Note 7 to the 2005 Annual Consolidated Financial Statements for additional information on the Aeroplan credit facilities.

DEBT AND 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. Future minimum lease payments under existing operating leases of aircraft and other property, excluding leases accounted for as capital leases and Variable Interest Entities (VIEs), amounted to $3.4 billion at December 31, 2005 compared to $3.3 billion at December 31, 2004. Refer to the table below for additional information on the Corporation's future minimum lease payments under existing operating leases.

SUMMARY OF PRINCIPAL REPAYMENT AND FUTURE MINIMUM LEASE PAYMENT REQUIREMENTS AT DECEMBER 31, 2005

The table below summarizes the Corporation's principal repayment requirements at December 31, 2005 through to 2010 on long-term debt, capital lease obligations, and aircraft, engine and fuel facility debt consolidated as VIEs under AcG-15. The table also summarizes the Corporation's future minimum lease payments under existing operating leases at December 31, 2005.

($ millions)	2006	2007	2008	2009	2010
Long-term debt principal obligations	48	50	70	349	35
Debt consolidated under AcG-15 [1]	76	119	117	59	118
Capital lease principal obligations	141	174	172	84	82
Total long-term debt and capital lease obligations	**265**	**343**	**359**	**492**	**235**
Future minimum lease payments under existing aircraft operating leases	458	406	335	300	259
Future minimum lease payments under existing leases for other property	83	68	51	37	28
Total future minimum lease payments under existing leases	**541**	**474**	**386**	**337**	**287**

(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$36 million. In 2008, amounts due of approximately US$51 million relate to end of lease obligations with current aircraft fair values of approximately US$93 million. In 2010, amounts due of approximately US$54 million relate to end of lease obligations with current aircraft fair values of approximately US$59 million. In these leasing transactions, Air Canada has the option to either 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.*

CAPITAL EXPENDITURES

The table below provides projections for aircraft expenditures for firm aircraft orders, net of aircraft financing, combined with planned and committed expenditures for aircraft engines, inventory, property and equipment, net of related financing, if applicable, for the years 2006 through to 2010.

In addition to the firm aircraft orders, the Corporation's purchase agreements include options, cancelable orders and purchase rights, all of which are not included in these projections.

Projected Planned and Committed Capital Expenditures [1] ($ millions)	2006	2007	2008	2009	2010
Projected committed expenditures	826	1,950	1,213	428	837
Projected planned but uncommitted expenditures	252	405	317	273	285
Total projected expenditures	1,078	2,355	1,530	701	1122
Projected financing on committed expenditures	(467)	(1,560)	(1,090)	(297)	(801)
Total projected expenditures, net of financing	**611**	**795**	**440**	**404**	**321**

(1) *US dollar amounts are converted using the December 31, 2005 noon day rate of $1.1659. Final aircraft delivery prices include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day LIBOR rate at December 31, 2005.*

BOEING

In November 2005, the Corporation concluded agreements with The Boeing Company (Boeing) for the acquisition of up to 36 Boeing 777 aircraft and up to 60 Boeing 787 Dreamliners. The agreements include firm orders for 18 Boeing 777 aircraft, plus purchase rights for an additional 18 aircraft, in a yet-to-be determined mix of the 777 family's newest models. Deliveries of the Boeing 777 aircraft are scheduled to commence in March 2007. Seven Boeing 777 aircraft are expected to be delivered in 2007, nine aircraft in 2008, and two aircraft in 2009. The agreements also include firm orders for 14 Boeing 787 Dreamliners, plus options and purchase rights for an additional 46 aircraft. Air Canada's first Boeing 787 aircraft is scheduled for delivery in 2010. The Corporation has received financing commitments from Boeing and the engine manufacturer covering all firm aircraft orders for approximately 90 per cent of the capital expenditure.

The Corporation expects to remove from operations all 20 Airbus A330 and A340 aircraft as well as all 12 Boeing 767-200 aircraft as the new committed Boeing 777 and 787 aircraft are delivered. The debt and other obligations associated with these aircraft are approximately US$850 million at December 31, 2005.

EMBRAER

In 2004, Air Canada signed a definitive purchase agreement with Empresa Brasileira de Aeronautica S.A. (Embraer) covering firm orders for 45 Embraer 190 series aircraft as well as 15 Embraer 175 series aircraft. The purchase agreement also contains rights to exercise options for up to 60 additional Embraer 190 series aircraft as well as providing for conversion rights to other Embraer models.

Deliveries of the 15 Embraer 175 series aircraft commenced in July 2005 and the last aircraft was delivered in January 2006. All Embraer 175 deliveries were 80 percent financed by a third party.

The Embraer 190 series deliveries commenced in December 2005. At December 31, 2005, three of the Embraer 190 series firm aircraft orders have been completed and the remaining 42 deliveries are planned to be completed by January 2008. For the first 18 firm Embraer 190 deliveries, the Corporation has received loan commitments from a syndicate of banks and the manufacturer covering 80 percent of the capital expenditure. For the remaining 27 firm Embraer 190 deliveries, the Corporation has received loan commitments from the manufacturer covering 85 percent of the capital expenditures.

BOMBARDIER

In 2004, Air Canada signed a definitive purchase agreement with Bombardier Inc. (Bombardier) for the acquisition of regional jet aircraft. The agreement with Bombardier covered firm orders for 15 Bombardier CRJ705 and 15 Bombardier CRJ200 aircraft, all of which were delivered to the Corporation in late 2004 and throughout 2005. The agreement with Bombardier contains orders for 15 additional Bombardier CRJ200 aircraft which can be cancelled without penalty. The agreement also contains options for an additional 45 aircraft. As of February 9, 2006, no commitments have been made on the cancelable orders or on the additional options for the 45 aircraft. The Corporation has financing commitments for 85 percent of capital expenditures from the manufacturer on the cancelable aircraft orders should the Corporation decide to commit to acquire these aircraft.

AIRCRAFT RECONFIGURATION

On November 10, 2005, Air Canada announced its intention to provide all-new seating across its entire fleet, featuring a state-of-the-art lie-flat seat for its international Executive First customers. In addition, Air Canada is outfitting its Executive Class cabins on North American routes with new premium seats, and all of its Hospitality cabins fleet-wide will be reconfigured with new seats offering personal seat back entertainment systems with an increased choice of audio and video programming. The capital expenditures relating to this program are reflected in the projected planned and committed expenditures table on the previous page.

PROJECTED CASH DEBT PAYMENTS FOR COMMITTED AIRCRAFT DELIVERIES

The following table provides for the Corporation's cash debt payments for the future firm aircraft deliveries for the years 2006 through to 2010.

The projected principal repayments disclosed below are based on the assumption that all aircraft acquisitions will be financed under debt. Air Canada has not yet decided whether certain aircraft acquisitions will be financed under debt or operating lease arrangements.

($ millions) (1)	2006	2007	2008	2009	2010
Principal repayment on aircraft-related long-term debt	8	37	95	130	154

(1) Based on 10-year US treasury rate and swap rate as at December 31, 2005. US dollar amounts are converted using the December 31, 2005 noon day rate of $1.1659. Final aircraft delivery prices include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day LIBOR rate at December 31, 2005.

PENSION FUNDING OBLIGATIONS

The table below provides the Corporation's 2005 pension funding as well as projections for its pension funding obligations from 2006 through to 2010:

($ millions)	2005	2006	2007	2008	2009	2010
Past service domestic registered plans	99	198	214	207	211	212
Current service domestic registered plans	133	139	141	146	152	158
Other pension arrangements	52	52	56	61	65	69
Projected pension funding obligations	**284**	**389**	**411**	**414**	**428**	**439**

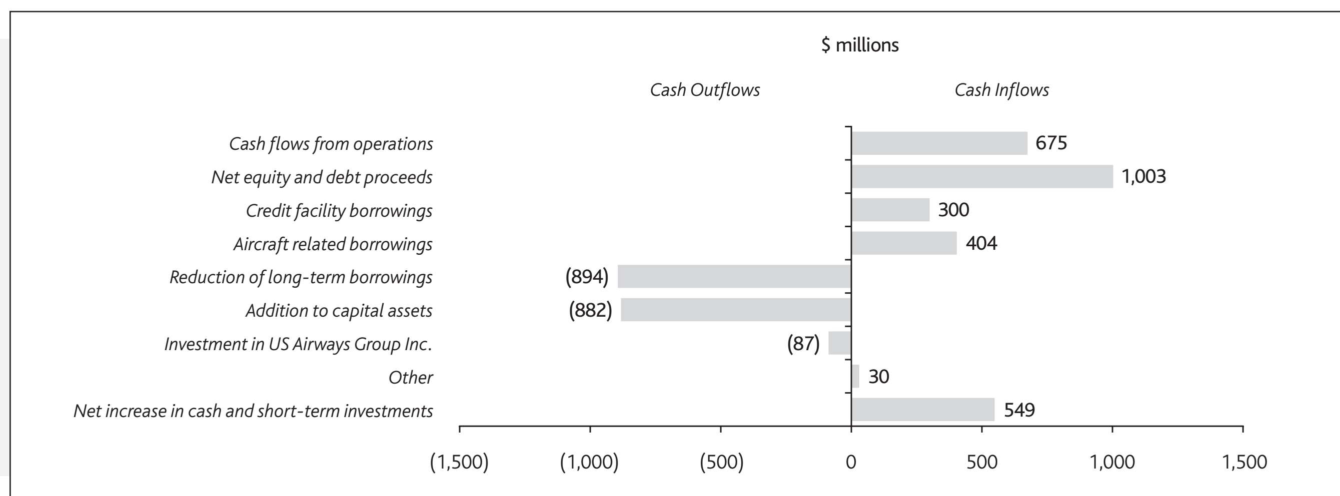
The above pension funding requirements are in respect of the Corporation's pension arrangements. For Domestic Registered Plans, the funding requirements are based on the minimum past service contributions from the January 1, 2005 actuarial valuations plus a projection of the current service contributions. The required contributions disclosed above do not reflect actual experience of 2005 and assume no future gains and losses on plan assets and liabilities over the projection period. The changes in the economic conditions, mainly the return on assets generated by the fund and the change in interest rates, will impact projected required contributions.

FINANCIAL MANAGEMENT – 2005 VERSUS 2004 COMBINED

The table below reflects the 2005 Consolidated Statement of Cash Flow of ACE, and the 2004 Combined Statement of Cash Flow, as defined on page 6 of this MD&A.

Consolidated Statement of Cash Flow ($ millions) Cash flows from (used for)	ACE Twelve months ended December 31, 2005	2004 Combined Twelve months ended December 31, 2004
Operating		
Income (loss) for the period	258	(880)
Adjustments to reconcile to net cash provided by operations		
Reorganization and restructuring items	-	786
Depreciation, amortization and obsolescence	482	397
Loss on sale of and provisions on assets	28	75
Aeroplan dilution gain	(190)	-
Foreign exchange	(83)	(202)
Future income taxes	116	6
Employee future benefit funding (more than) less than expense	(74)	74
Decrease (increase) in accounts receivable	(43)	78
Decrease (increase) in spare parts, materials and supplies	(92)	(30)
Increase (decrease) in accounts payable and accrued liabilities	45	(222)
Increase (decrease) in advance ticket sales, net of restricted cash	132	119
Aircraft lease payments (in excess of) less than rent expense	33	(45)
Other	63	92
Cash flows from (used for) operating activities before the following items:	675	248
Settlement of lease obligations	-	(290)
Rebate on lease settlement	-	33
Payment of restructuring obligation	-	(45)
Fees conditional on emergence	-	(12)
	675	(66)
Financing		
Issue of share capital	452	1
Issue of convertible notes	319	-
Issue of Aeroplan subsidiary units	232	-
Aircraft-related borrowings	404	233
Credit facility borrowings	300	80
Reduction of long-term debt and capital lease obligations	(894)	(425)
Preferred shares issued to Cerberus for cash	-	238
Shares issued for cash under Rights Offering	-	852
GE DIP financing	-	-
Drawdown of exit financing	-	527
Distributions paid to non-controlling interest holders	(8)	-
Other	(4)	(2)
	801	1,504
Investing		
Short-term investments	(465)	35
Sale of Aeroplan units	35	-
Additions to capital assets	(882)	(457)
Proceeds from sale of assets	42	2
Cash collateralization of letters of credit	(35)	(21)
Investment in US Airways	(87)	-
	(1,392)	(441)
Increase in cash and cash equivalents	84	997
Cash and cash equivalents, beginning of period	1,481	484
Cash and cash equivalents transferred to the Corporation	-	-
Cash and cash equivalents, end of period	1,565	1,481
Short-term investments	616	151
Total	2,181	1,632

2005 Changes in Cash Position Including Short-Term Investments



CASH FLOWS FROM (USED FOR) OPERATIONS

The 2005 cash flows from operations were $675 million. This compared to cash flows used for operations of $66 million in 2004 Combined. 2004 Combined cash flows used for operations included $314 million of net payments made on implementation of the consolidated plan of reorganization, compromise and arrangement (the Plan), relating mainly to the settlement of restructuring obligations. Before these payments, 2004 Combined cash flows from operations amounted to $248 million.

Further components of the cash flow change are described below:

Accounts receivable was a use of funds of $43 million in 2005. This compared to a source of funds of $78 million in 2004 Combined, a decrease of $121 million. The main factor in the use of funds was an increase in commodity tax receivables on aircraft deliveries which will be collected in the first quarter of 2006. Another factor in the use of funds included an increase in cargo-related receivables due mainly to the increase in cargo revenues over 2004 Combined.

Spare parts, materials and supplies was a use of funds of $92 million, compared to a use of funds of $30 million in 2004 Combined. The use of funds reflected increases in spare parts for servicing third party maintenance contracts as well as spare parts for the Embraer and CRJ aircraft deliveries during the year. In addition, fuel inventories increased $41 million during the year, in part reflecting the higher cost of fuel.

In 2005, employee future benefit funding exceeded the accounting expense by $74 million.

Other cash from operations of $63 million during the year included the change in prepaid expenses and other current assets. In 2005, a prepayment made while under CCAA was repatriated resulting in a cash inflow of $63 million.

CASH FLOWS FROM (USED FOR) FINANCING ACTIVITIES

In 2005, aircraft-related borrowings totaled $404 million and related mainly to the acquisition of Embraer aircraft.

In 2005, reduction of long-term debt and capital lease obligations amounted to $894 million. The Corporation 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 GE Limited Recourse Loan. Scheduled payments of $158 million were made on capital lease obligations and scheduled payments of $43 million were made on the secured non-revolving term credit facility with Amex Bank of Canada Inc. Other mandatory scheduled payments amounted to $124 million.

In addition, in 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 per cent Convertible Senior Notes due 2035 (Convertible Notes) for net proceeds of $319 million. Also in 2005, ACE and Aeroplan Income Fund (the Fund) completed an Initial Public Offering of the Aeroplan Income

Fund for aggregate net proceeds of $267 million, of which $232 million is included in financing activities and $35 million is included in investing activities. The amount of $35 million included in investing activities relates to the net over-allotment proceeds which were the sale to the Fund of units held by ACE. Also in 2005, the Corporation issued 521,976 common shares on the exercise of stock options for cash consideration of $10 million.

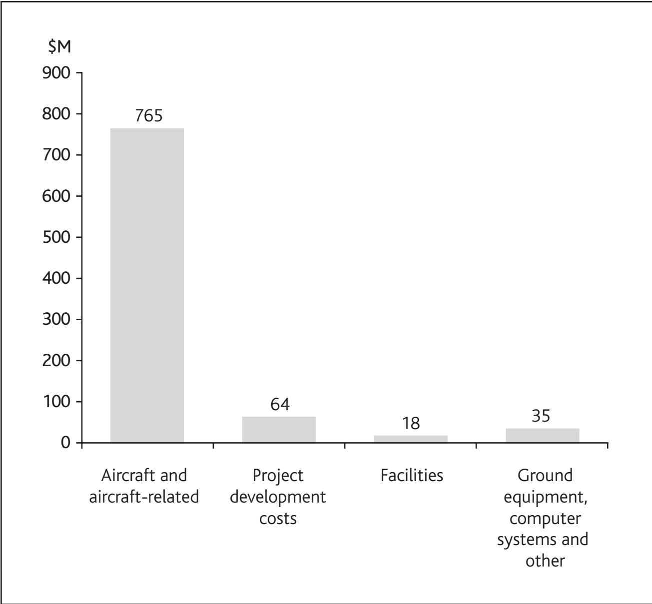
In 2005, Air Canada entered into a senior secured syndicated revolving credit facility in an aggregate amount of up to $300 million or the US dollar equivalent. At December 31, 2005, the full amount available under the credit facility was undrawn.

During 2005, Aeroplan 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 thereof) term facility (Term A Facility), a $100 million (or the U.S. dollar equivalent thereof) acquisition facility (Term B Facility) and a $75 million (or the U.S. dollar equivalent thereof) revolving term credit facility. The Term A Facility was drawn on June 29, 2005 in the amount of $300 million in order to fund a portion of the $400 million Aeroplan Miles Redemption Reserve, included in cash and cash equivalents and short-term investments. At December 31, 2005, no amounts were drawn under the Term B Facility.

CASH FLOWS FROM (USED FOR) INVESTING ACTIVITIES

In 2005, short-term investments increased by $465 million. Short-term investments have original maturities over three months, but not more than one year. These investments can be readily converted to cash and are with institutions that have high credit ratings.

2005 Capital Expenditures



- In 2005, additions to capital assets totaled $882 million. Included in this amount were $508 million related to the purchase of Embraer aircraft and $185 million related to a deposit for the acquisition of Boeing aircraft partly offset by a $50 million refund relating to deposits on Bombardier aircraft which have been delivered. Other additions to capital assets included inventory and spare engines, ground equipment, facilities and system development costs.

US AIRWAYS GROUP INC.

On September 27, 2005, the Corporation invested $87 million (US$75 million) in US Airways Group Inc. (US Airways) in conjunction with the carrier's exit from US bankruptcy proceedings. The Corporation's investment represented approximately 6 per cent of the equity of US Airways at December 31, 2005. 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.

FLEET

AIR CANADA

In 2005, Air Canada took delivery of one Airbus A340-300 aircraft, three Boeing 767-300 aircraft, 14 Embraer 175 and three Embraer 190 aircraft. During 2005, three Airbus A321 aircraft and one Airbus A320 aircraft were returned to the lessors, one Boeing 747-400 aircraft was sold and one Boeing 737-200 aircraft was donated to the Museum of Alberta. In addition, 15 Bombardier CRJ100 aircraft were transferred to Jazz and one Boeing 767-200 aircraft was removed from the fleet. The average age of Air Canada's operating fleet was 9.5 years at December 31, 2005. Air Canada's operating fleet, excluding Jazz aircraft, at December 31, 2005, was as described below:

	Total seats	Number of operating aircraft (1)	Average age of operating aircraft	Owned (2)	Capital Lease (2)	Consolidated under AcG-15 (2)	Operating Lease
Widebody Aircraft							
Airbus A340-500	267	2	1.5	2	-	-	-
Airbus A340-300	285-286	10	7.7	-	8	-	2
Airbus A330-300	274	8	5.2	-	8	-	-
Boeing 767-300	203-222	33	12.5	1	2	6	24
Boeing 767-200	207	12	19.4	12	-	-	-
Narrowbody Aircraft							
Airbus A321	166	10	3.8	-	-	5	5
Airbus A320	140	51	12.8	-	-	-	51
Airbus A319	120	48	7.0	-	17	17	14
Embraer 190	93	3	0.0	3	-	-	-
Embraer 175	73	14	0.3	14	-	-	-
CRJ100	50	10	10.6	-	-	10	-
Total Operating Aircraft		201	9.5	32	35	38	96

(1) Excludes aircraft which have been permanently removed from service.
(2) Owned aircraft as well as capital leases and leases consolidated under AcG-15 are carried on the Consolidated Statement of Financial Position.

The following table reflects the impact on Air Canada's fleet of the future committed aircraft deliveries and projected aircraft removals resulting from the new deliveries. The aircraft options, cancelable orders and purchase rights are not included in this table.

	Number of operating aircraft at December 31, 2005	Future committed aircraft deliveries at December 31, 2005	Estimated future projected aircraft removals	Resulting number of operating aircraft
Widebody Aircraft				
Boeing 777 – 300ER/200LR/200F	-	18	-	18
Boeing 787 – 900/800	-	14	-	14
Boeing 767-300	33		-	33
Boeing 767-200	12		(12)	-
Airbus A340-500	2		(2)	-
Airbus A340-300	10		(10)	-
Airbus A330-300	8		(8)	-
Narrowbody Aircraft				
Airbus A321	10	-	(3)	7
Airbus A320	51	-	(10)	41
Airbus A319	48	-	(3)	45
Embraer 190	3	42	-	45
Embraer 175	14	1	-	15
CRJ100 (1)	10	-	(10)	-
Total Operating Aircraft	201	75	(58)	218

(1) The 10 CRJ100s will be transferred to Jazz.

In conjunction with the deliveries of the Boeing 777 and 787 aircraft, the Corporation expects to remove 20 widebody Airbus aircraft (two A340-500s, 10 A340-300s and eight A330-300s) from its fleet as well as 12 Boeing 767-200 aircraft. Two of the Airbus A340-300 aircraft are held under operating leases with lease terminations in 2009.

JAZZ

During 2005, Jazz took delivery of 15 Bombardier CRJ705 aircraft and 13 Bombardier CRJ200 aircraft, nine of which were entered into service at December 31, 2005 and four of which were received in 2005 but not entered into service at December 31, 2005 and are not shown as operating aircraft. In addition, 15 Bombardier CRJ100 aircraft were transferred from Air Canada to Jazz. Also during 2005, eight BAe 146 aircraft and four Dash 8-100 aircraft were returned to lessors and 27 Fokker F28 aircraft were sold. The average age of Jazz's operating fleet was 11.2 years at December 31, 2005. Jazz's operating fleet at December 31, 2005 was as described below:

	Total seats	Number of operating aircraft (1)	Average Age of operating aircraft	Owned	Capital Lease	Consolidated under AcG-15	Operating Lease
Bombardier CRJ705	75	15	0.5	-	-	-	15
Bombardier CRJ200	50	27	3.9	-	-	-	27
Bombardier CRJ100	50	15	9.9	-	-	13	2
Dash 8-300	50	26	15.8	17	-	-	9
Dash 8-100	37	38	18.0	38	-	-	-
Total Operating Aircraft		**121**	**11.2**	**55**	**-**	**13**	**53**

(1) Excludes aircraft which have been permanently removed from service.

Jazz has a planned operating fleet of 135 aircraft in July 2006. The increase is due to the addition of 10 CRJ100 aircraft transferred from Air Canada and six CRJ200 aircraft as well as the removal of two Dash 8-100 aircraft.

PEOPLE

In 2004, the Corporation concluded long-term collective agreements with all union groups which expire in 2009. These collective agreements provide for a process to revise wage levels in 2006 by negotiation or, failing negotiation, by mediation or arbitration without resort to strike or lock out.

In the fourth quarter of 2005, the Corporation had an average of 33,090 FTE employees compared to an average of 31,991 FTE employees in the fourth quarter of 2004. This reflects a 3 per cent increase from the fourth quarter of 2004, as shown in the table below:

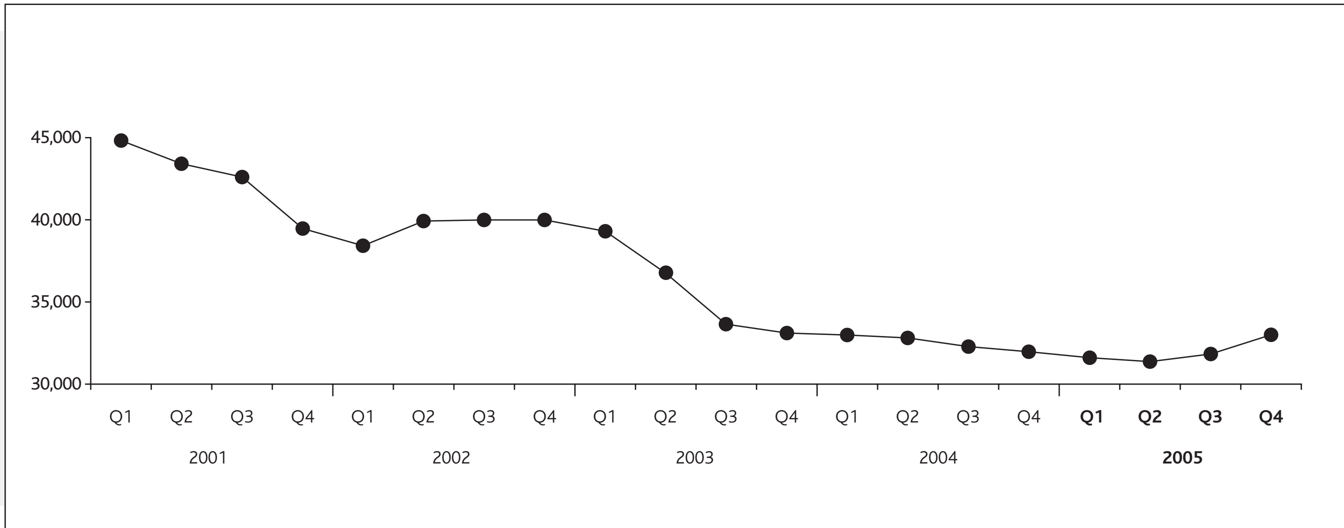
	Union	4th Quarter 2005	4th Quarter 2004	Change	% Change
Transportation Services					
Management & Administrative Support	-	3,565	3,523	42	1
Pilots	ACPA	2,541	2,563	(22)	(1)
Flight Attendants	CUPE	6,010	5,837	173	3
Customer Sales & Service Agents	CAW / IBT	3,927	3,942	(15)	(0)
Technical Services, Ramp & Cargo	IAMAW	6,924	6,775	149	2
UK Unionized employees	AMICUS / TGWU	682	749	(67)	(9)
Other unionized employees		528	494	34	7
Transportation Services total (1)		**24,177**	**23,883**	**294**	**1**
Aeroplan		**1,057**	**1,185**	**(128)**	**(11)**
ACTS		**4,055**	**3,560**	**495**	**14**
Jazz		**3,801**	**3,363**	**438**	**13**
ACE		**33,090**	**31,991**	**1,099**	**3**

Note: Certain prior year's information was reclassified to conform to the current year's presentation.

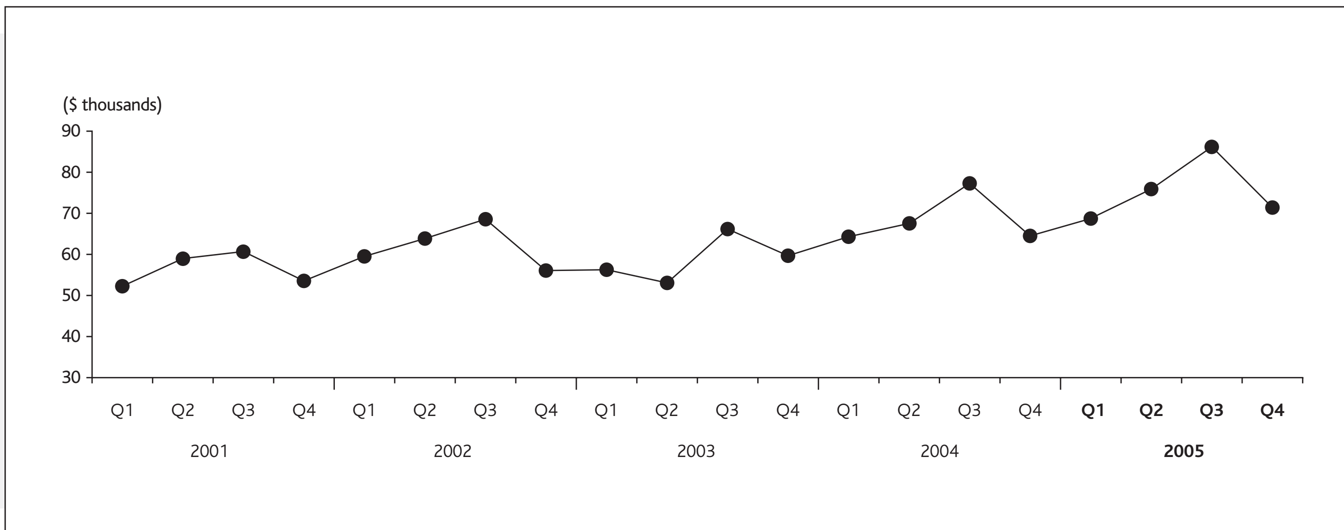
(1) Transportation Services includes the following FTEs: Air Canada 15,414; Air Canada Cargo 1,223; ACGHS 7,038; Air Canada Vacations 441; Other 61.

The graphs below reflect the significant reduction in average quarterly FTE employee levels from 2001 to 2005 as well as the increase in productivity as measured by operating revenue per FTE employee and ASM per FTE employee:

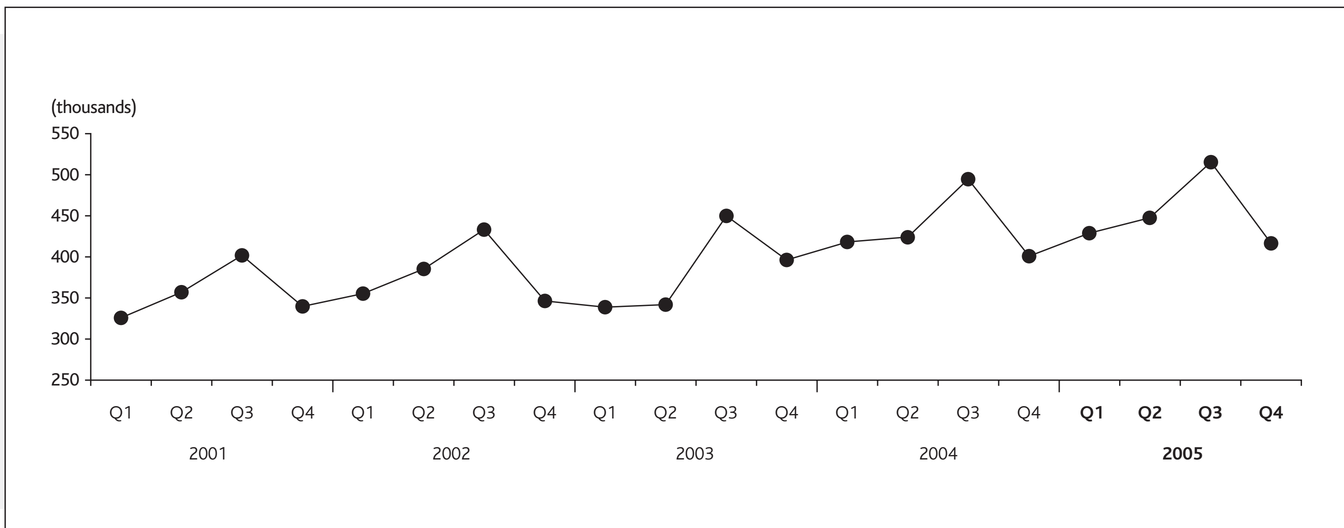
Average Number of FTE Employees



Operating Revenue per FTE Employee



ASM per FTE Employee



QUARTERLY FINANCIAL DATA

The table below describes quarterly financial results and major operating statistics of Air Canada for the first three quarters of 2004 and the financial results of ACE for the fourth quarter of 2004 and the full year 2005:

Quarterly Financial Results and Major Operating Statistics Condensed Consolidated	Predecessor Company Air Canada			ACE				
$ millions (except per share figures)	Quarter 1 2004	Quarter 2 2004	Quarter 3 2004	Quarter 4 2004	Quarter 1 2005	Quarter 2 2005	Quarter 3 2005	Quarter 4 2005
Passenger revenues	1,661	1,844	2,123	1,681	1,739	2,100	2,461	1,969
Cargo revenues	126	137	142	151	135	147	162	176
Other revenues	334	240	231	230	303	211	210	217
Operating revenues	2,121	2,221	2,496	2,062	2,177	2,458	2,833	2,362
Operating expenses	2,266	2,199	2,253	2,065	2,187	2,281	2,513	2,397
Operating income (loss) before reorganization and restructuring items	**(145)**	**22**	**243**	**(3)**	**(10)**	**177**	**320**	**(35)**
Reorganization and restructuring items	(132)	(426)	(313)	-	-	-	-	-
Non-operating income (expense)	(43)	(72)	(131)	(47)	(63)	104	(38)	(88)
Income (loss) before the following items:	**(320)**	**(476)**	**(201)**	**(50)**	**(73)**	**281**	**282**	**(123)**
Non-controlling interest	-	-	-	-	(3)	(4)	(9)	(8)
Foreign exchange gain (loss) on non-compromised monetary items	17	(34)	121	78	(15)	(53)	125	(11)
Recovery of (provision for) income taxes	(1)	-	(1)	(13)	14	(56)	(128)	39
Net income (loss)	**(304)**	**(510)**	**(81)**	**15**	**(77)**	**168**	**270**	**(103)**
Earnings (loss) (1)								
Per share - basic	**(2.53)**	**(4.24)**	**(0.67)**	**0.17**	**(0.87)**	**1.67**	**2.66**	**(1.02)**
Per share - diluted	**(2.53)**	**(4.24)**	**(0.67)**	**0.17**	**(0.87)**	**1.49**	**2.33**	**(1.02)**
Revenue passenger miles (millions)	10,057	10,836	12,853	9,681	10,586	11,613	13,981	10,584
Available seat miles (millions)	13,797	13,931	15,993	12,815	13,566	14,487	16,961	13,808
Passenger load factor (%)	72.9	77.8	80.4	75.5	78.0	80.2	82.4	76.7
Operating expense per available seat mile (CASM) (cents)	16.4	15.8	14.1	16.1	16.1	15.7	14.8	17.4
Operating expense per available seat mile excluding fuel expense (cents)	14.0	13.1	11.2	12.7	13.1	12.1	10.8	13.2

(1) Pursuant to the Plan as further described in Note 19 to the 2005 Annual Consolidated Financial Statements, all issued and outstanding options of Air Canada and warrants were cancelled without payment or consideration on September 30, 2004. In addition, a new ACE share capital structure was established, as further described in Note 12 to the 2005 Annual Consolidated Financial Statements.

SEGMENT INFORMATION

The segment reporting structure for the Corporation reflects four reportable segments: Transportation Services, Aeroplan, Jazz and ACTS. In the Predecessor Company, there was only one reportable segment.

This segment reporting was applied on a prospective basis. Prior period segment information is presented for comparative purposes for Aeroplan and Jazz, however, for the reasons described below, segment reporting information pertaining to periods prior to September 30, 2004 is not directly comparable.

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.

In the Predecessor Company, ACTS was a cost centre within Air Canada and discrete financial information is not available. In addition, a capacity purchase agreement between Air Canada and Jazz came into effect on September 30, 2004. Jazz segment information, for periods prior to September 30, 2004, is not comparable as a result of this new agreement.

As described on page 10 of this MD&A, the Corporation changed the accounting policy effective September 30, 2004 for the recognition of its revenues relating to the loyalty program. As a result, Aeroplan segment results for periods prior to September 30, 2004 are not directly comparable.

FOURTH QUARTER SEGMENT RESULTS

The tables on the following page provide total amounts reported by each segment in the consolidated financial statements for the fourth quarter of 2005 and in the consolidated financial statements for the fourth quarter of 2004.

($ millions)	Three months ended December 31, 2005 Transportation Services	Aeroplan	Jazz	ACTS	Inter-Segment Elimination	ACE Consolidated
Passenger revenue	1,969	-	-	-	-	1,969
Cargo revenue	176	-	-	-	-	176
Other revenue	25	150	3	39	-	217
External revenue	2,170	150	3	39	-	2,362
Inter-segment revenue	37	4	301	153	(495)	-
Total revenue	**2,207**	**154**	**304**	**192**	**(495)**	**2,362**
Aircraft rent	90	-	28	-	(1)	117
Amortization of capital assets	110	3	4	8	-	125
Other operating expenses	2,098	121	238	192	(494)	2,155
Total operating expenses	**2,298**	**124**	**270**	**200**	**(495)**	**2,397**
Operating income (loss)	**(91)**	**30**	**34**	**(8)**	**-**	**(35)**
Total non-operating income (expense), non-controlling interest, foreign exchange and income taxes	(62)	-	(2)	(4)	-	(68)
Segment Results	**(153)**	**30**	**32**	**(12)**	**-**	**(103)**
Operating Margin %	**(4.1)**	**19.5**	**11.2**	**(4.2)**	**-**	**(1.5)**
EBITDAR [(1)]	**109**	**33**	**66**	**0**	**(1)**	**207**

($ millions)	Three months ended December 31, 2004 Transportation Services	Aeroplan	Jazz	ACTS	Inter-Segment Elimination	ACE Consolidated
Passenger revenue	1,681	-	-	-	-	1,681
Cargo revenue	151	-	-	-	-	151
Other revenue	44	121	3	62	-	230
External revenue	1,876	121	3	62	-	2,062
Inter-segment revenue	54	6	185	106	(351)	-
Total revenue	**1,930**	**127**	**188**	**168**	**(351)**	**2,062**
Aircraft rent	103	-	9	-	(1)	111
Amortization of capital assets	73	1	4	7	-	85
Other operating expenses	1,812	104	153	150	(350)	1,869
Total operating expenses	**1,988**	**105**	**166**	**157**	**(351)**	**2,065**
Operating income (loss)	**(58)**	**22**	**22**	**11**	**-**	**(3)**
Total non-operating income (expense), foreign exchange and income taxes	26	-	(4)	(4)	-	18
Segment Results	**(32)**	**22**	**18**	**7**	**-**	**15**
Operating Margin %	**(3.0)**	**17.3**	**11.7**	**6.5**	**-**	**(0.1)**
EBITDAR [(1)]	**118**	**23**	**35**	**18**	**(1)**	**193**

(1) Refer to "Non-GAAP Financial Measures" on page 8 of this MD&A for additional information on EBITDAR.

2005 SEGMENT RESULTS

Total amounts reported by each segment in the consolidated financial statements for the full year 2005 are as follows:

	Twelve months ended December 31, 2005					
($ millions)	Transportation Services	Aeroplan	Jazz	ACTS	Inter-Segment Elimination	ACE Consolidated
Passenger revenue	8,269	-	-	-	-	8,269
Cargo revenue	620	-	-	-	-	620
Other revenue	117	627	10	187	-	941
External revenue	9,006	627	10	187	-	9,830
Inter-segment revenue	194	13	1,013	567	(1,787)	-
Total revenue	**9,200**	**640**	**1,023**	**754**	**(1,787)**	**9,830**
Aircraft rent	343	-	80	-	(6)	417
Amortization of capital assets	424	8	18	32	-	482
Other operating expenses	8,259	530	796	675	(1,781)	8,479
Total operating expenses	**9,026**	**538**	**894**	**707**	**(1,787)**	**9,378**
Operating income	**174**	**102**	**129**	**47**	**-**	**452**
Total non-operating income (expense), non-controlling interest, foreign exchange and income taxes	(167)	(2)	(11)	(14)	-	(194)
Segment Results	**7**	**100**	**118**	**33**	**-**	**258**
Total assets	**11,001**	**674**	**504**	**381**	**(713)**	**11,847**
Additions to capital assets	**849**	**12**	**16**	**5**	**-**	**882**
Operating Margin %	**1.9**	**15.9**	**12.6**	**6.2**	**-**	**4.6**
EBITDAR (1)	**941**	**110**	**227**	**79**	**(6)**	**1,351**

(1) Refer to "Non-GAAP Financial Measures" on page 8 of this MD&A for additional information on EBITDAR.

Subsequent to the dilution of ACE's interest in Aeroplan, a non-controlling interest charge is recorded upon the consolidation of Aeroplan. As Aeroplan'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 earnings for the period or the amount of distributions to the non-controlling interest holder during the period.

Refer to Note 15 to the 2005 Annual Consolidated Financial Statements for additional information on segment results.

ANALYSIS OF RESULTS – FOURTH QUARTER 2005 VERSUS FOURTH QUARTER 2004

TRANSPORTATION SERVICES

For the fourth quarter of 2005, the Transportation Services segment reported an operating loss of $91 million, a deterioration of $33 million compared to the operating loss of $58 million recorded in the same quarter of 2004.

EBITDAR for Transportation Services amounted to $109 million, a decrease of $9 million from the fourth quarter of 2004, despite a $146 million rise in the cost of fuel. A factor in the deterioration of EBITDAR, other than fuel expense, was in the weaker results of Air Canada Vacations largely due to the impact of the hurricane season. Refer to page 9 of this MD&A for a reconciliation of EBITDAR by segment.

Passenger revenues increased $288 million or 17 per cent on a capacity increase of 8 per cent reflecting both yield improvements and traffic growth. The system yield improvement was primarily due to increased fare levels in the domestic and US transborder markets to partially offset higher fuel costs. An improved domestic competitive position and a stronger market demand for the higher-priced Tango Plus product were also factors in the domestic yield improvement. Additionally, US transborder yield also improved as a result of a redesign of conditions underlying fares aimed at the business-oriented market which occurred in the fourth quarter of 2005. International yields rose just under 1 per cent as higher fuel surcharges were mostly offset by weaker foreign currencies and competitive pricing. Higher unit revenues (passenger revenue per ASM), due mostly to increased North America fare levels but also to a 1.2 percentage point rise in passenger load factor, offset the growth in unit cost resulting primarily from the sharply higher fuel prices.

Operating expenses increased $310 million or 16 per cent over the fourth quarter of 2004 and included a $146 million or 34 per cent increase in fuel expense as well as an increase in inter-segment fees (which are eliminated on consolidation) charged by Jazz under the CPA of approximately $70 million mainly reflecting an increase in Jazz's block hours, capacity and fleet size. Under Air Canada's CPA with Jazz, Jazz is paid fees based on a variety of different operational metrics in addition to aircraft ownership costs. Jazz is also reimbursed for certain pass-through costs which are further detailed in the discussion on the Jazz segment. Other increases included depreciation, amortization and obsolescence, airport and navigation fees, aircraft maintenance, materials and supplies expense and salaries, wages and benefits. Decreases in operating expenses over the 2004 quarter included commissions, aircraft rent, advertising and promotion expenses and various other reductions.

AEROPLAN

Operating revenues amounted to $154 million in the fourth quarter of 2005, up $27 million from the fourth quarter of 2004, primarily due to an increase in revenues recognized from the sale of redemption of Aeroplan Miles (including breakage). The increase in revenues recognized was mainly attributable to an increase in the number of Aeroplan Miles redeemed combined with increased capacity available from Air Canada related to Avenue rewards, which were introduced in late April 2004, as well as the continued expansion of non-air rewards.

Operating expenses amounted to $124 million in the fourth quarter of 2005, an increase of $19 million from the fourth quarter of 2004, mainly due to a higher cost of rewards primarily attributable to a greater number of Aeroplan Miles redeemed.

Operating income amounted to $30 million in the fourth quarter of 2005 compared to $22 million in the fourth quarter of 2004, an increase of $8 million or 36 per cent.

JAZZ

Under the initial CPA, effective for the period October 1, 2004 to December 31, 2005, and the new CPA, which became effective January 1, 2006, Jazz is paid fees based on a variety of different metrics, including block hours flown, cycles (number of take-offs and landings) and passengers in addition to certain variable and fixed aircraft ownership rates. In addition, Jazz is entitled to repayment of certain pass-through costs, including fuel, navigation, landing and terminal fees and certain other costs. Jazz is also eligible to receive payments for successfully achieving certain performance incentives on a quarterly basis related to on-time performance, controllable flight completion, baggage handling performance and overall customer satisfaction.

For the fourth quarter of 2005, Jazz reported an operating income of $34 million, an improvement of $12 million compared to the operating income of $22 million recorded in the same quarter of 2004. EBITDAR was $66 million in the fourth quarter of 2005 compared to EBITDAR of $35 million in the fourth quarter of 2004, an increase of $31 million or 89 per cent which is the result of fleet additions, increased hours of contract flying, cost control and performance incentives earned in the latest quarter. Refer to page 9 of this MD&A for a reconciliation of EBITDAR by segment.

Operating revenue was up $116 million or 62 per cent. The increase in revenues was due to a net increase of 30 aircraft operated by Jazz, an increase in block hours flown by these aircraft of 33 per cent, and an increase in the pass-through costs charged to Air Canada under the CPA of $52 million.

Operating expenses rose $104 million or 63 per cent compared to the fourth quarter of 2004, including an increase in fuel expense of $33 million or 114 per cent. Fuel expense is a pass-through cost charged to Air Canada under the CPA. Capacity, as measured by available seat miles (ASM), increased by 82 per cent. Unit cost for the fourth quarter of 2005 decreased by 10 per cent from the fourth quarter of 2004. Excluding fuel expense, unit cost was down 16 percent compared to the 2004 fourth quarter. Unit cost reductions were achieved in all expense categories except fuel expense, aircraft rent and terminal handling services. Unit aircraft rental costs increased quarter-over-quarter reflecting the new aircraft deliveries throughout 2005.

In the fourth quarter of 2005, non-operating expense amounted to $2 million, essentially unchanged from the fourth quarter of 2004. Gain on the disposal of property and equipment in the fourth quarter of 2005 was $1 million.

Net income for the fourth quarter of 2005 was $32 million compared to net income of $18 million recorded in the fourth quarter of 2004, an improvement of $14 million. The increase in net income was due to an increased fleet and effective cost control.

ACTS

During 2005, ACTS continued its focus on increasing its customer base and developing into a stand-alone MRO. In the fourth quarter of 2005, significant effort and focus went into the review and planned improvement of operational processes and systems.

Additionally, ACTS completed a review of all existing accounting policies and practices and, in many cases, implemented new practices consistent with those of a stand-alone MRO. This activity is expected to continue into the first quarter of 2006.

During the fourth quarter of 2005, ACTS changed its accounting policy, mainly related to engine maintenance services provided to Air Canada, from proportional performance to the completed contract method. This change in accounting policy was applied from October 1, 2004. The change in accounting policy had the effect of decreasing the reported segment results for the fourth quarter of 2004 by $11 million. The impact of this change was to defer costs and adjust revenues in relation to work in process at the end of each quarter. Additionally, in the fourth quarter of 2005, ACTS recorded other adjustments of $7 million including the results of a complete physical inventory count.

Inter-segment revenue for the fourth quarter of 2005 increased by $47 million or 44 per cent compared to the fourth quarter of 2004, mostly due to increased activity in engine and component maintenance for Air Canada. In addition, revenues for the fourth quarter of 2004 were negatively impacted by the change of accounting policy to the completed contract method which meant that the number of completed events during this first quarter of operation was significantly lower than the ongoing trend. Other revenue for the quarter decreased by $23 million mostly due to a reduction in third party revenue for engine maintenance due to increased competitive market conditions.

ACTS reported a net loss of $12 million for the fourth quarter of 2005 compared to net income of $7 million in the fourth quarter of 2004. The unfavorable variance to last year is mainly due to the reduced profitability of the airframe maintenance division. This reduced profitability is attributable primarily to greater than expected operational challenges relating to significant production capacity growth initiatives at ACTS' Montréal and Vancouver maintenance centers, which required the integration of additional staff and new customer processes.

OFF-BALANCE SHEET ARRANGEMENTS

GUARANTEES

As a result of the adoption of AcG-15 on January 1, 2005, 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 on the Consolidated Statement of Financial Position of the Corporation and, as a result, the residual value support previously applicable under these leasing agreements is no longer characterized as a guarantee of the Corporation, on an accounting basis.

RETAINED OR CONTINGENT INTEREST IN ASSETS TRANSFERRED

ACE has no material arrangements involving the transfer of assets to an unconsolidated entity where those assets serve as credit, liquidity or market risk support to that entity.

DERIVATIVE INSTRUMENTS

Under its risk management policy, the Corporation manages its exposure to changes in interest rates, foreign exchange rates and jet fuel prices through the use of various derivative financial instruments. The Corporation uses derivative financial instruments only for risk management purposes, not for generating trading profit. ACE's risk management policies and use of derivative financial instruments are further described in Note 17 to ACE's 2005 Annual Consolidated Financial Statements. The Corporation has entered into certain derivative financial instrument agreements to manage interest rate and currency risk in certain aircraft lease agreements.

INTEREST RATE CONTRACTS

During 2005, the Corporation reached a settlement with a third party related to interest rate swaps covering two Boeing 767 aircraft leases which 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 provided 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, in the third quarter of 2005. 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 rates. These swaps have not been designated as hedges for accounting purposes. At December 31, 2005, these two swaps have a fair value of $7 million in favour of the Corporation.

FOREIGN EXCHANGE CONTRACTS

At December 31, 2005, the Company has entered into foreign currency forward contracts and option agreements on US$521 million of future purchases. The fair value of these foreign currency contracts at December 31, 2005 is $1 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 gain (loss). The Corporation had no foreign exchange forward contracts outstanding at December 31, 2004.

The Corporation has entered into currency swap agreements for 16 Bombardier Regional Jet operating leases until lease terminations between 2007 and 2011. Currency swaps for five Canadian Regional Jet operating leases, with unrelated creditworthy third parties, were put in place on the inception of the leases and have a fair value at December 31, 2005 of $13 million in favour of third parties (2004 - $12 million in favour of unrelated creditworthy third parties), taking into account foreign exchange rates in effect at that time. Currency swaps for 11 Bombardier Regional Jet operating leases have a fair value at December 31, 2005 of $3 million in favour of the Corporation. These swaps have not been designated as hedges for hedge accounting purposes. The unrealized changes in fair value have been recorded in foreign exchange gain (loss).

FUEL CONTRACTS

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, beginning in September 2005 for a 24-month period.

At December 31, 2005, the Corporation had collar option structures in place to hedge a portion of its anticipated jet fuel requirements over the 2006 to 2007 period. For all heating and crude oil fuel hedges, the prices disclosed below do not include the jet fuel premium.

2005 Fuel Hedges
For 2005, the Corporation had hedged approximately 3 per cent of its 2005 jet fuel requirements through jet fuel-based contracts at prices that fluctuated between an average of US$75.00 to US$92.00 per barrel. All of the Corporation's fourth quarter 2005 hedges were also effectively jet fuel-based contracts. The Corporation had hedged 12 per cent of its fourth quarter 2005 jet fuel requirements at prices that fluctuated between an average of US$75.00 to US$92.00 per barrel.

2006 Fuel Hedges
For 2006, the majority of the Corporation's hedge positions are effectively in the form of jet fuel and heating oil-based contracts. The Corporation has hedged 21 per cent of its 2006 requirements at prices that can fluctuate between an average of US$75.00 to US$87.00 per barrel for the jet fuel contracts and an average of US$74.00 to US$86.00 per barrel for the heating-oil based contracts.

2007 Fuel Hedges
For 2007, the majority of the hedge positions are heating oil and crude oil-based contracts. The Corporation has hedged 13 per cent of its 2007 requirements at prices that can fluctuate between an average of US$74.00 to US$86.00 per barrel for the heating oil-based contracts and an average of US$56.00 to US$68.00 per barrel for the crude oil-based contracts.

Contracts entered into before October 1, 2005 did not qualify for hedge accounting whereas contracts entered into after October 1, 2005 do qualify for hedge accounting. Under hedge accounting, gains or losses on fuel hedging contracts are recognized in earnings as a component of aircraft fuel expense when the underlying jet fuel being hedged is consumed. Prior to these derivative instruments being designated as hedges for accounting purposes, an unrealized gain of $2 million was recorded in other non-operating expense. Subsequent to adopting fuel hedge accounting, the Corporation recognized a net loss of $3 million as a component of fuel expense on the Consolidated Statement of Operations. The fair value of the Corporation's fuel hedging agreements at December 31, 2005 was $3 million in favour of third parties.

CHANGES IN ACCOUNTING POLICIES

CONSOLIDATION OF VARIABLE INTEREST ENTITIES

The Corporation adopted Accounting Guideline 15 – Consolidation of Variable Interest Entities (AcG-15) effective January 1, 2005. Refer to Note 2 to the 2005 Annual Consolidated Financial Statements for additional information on the adoption of AcG-15. 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 (variable interest entity) in its consolidated financial statements.

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.

ASSET RETIREMENT OBLIGATIONS

The Corporation records 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. 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.

FUTURE ACCOUNTING STANDARD CHANGES

Financial Instruments and Hedges

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 that all financial instruments, including derivatives, are to be included on a company's Statement of Financial Position and measured, either at their fair values or, in limited circumstances when fair value may not be considered most relevant, at cost or amortized cost. Financial instruments intended to be held-to-maturity should be measured at amortized cost. Existing requirements for hedge accounting are extended to specify how hedge accounting should be performed. Also, a new location for recognizing certain unrealized gains and losses – other comprehensive income – has been introduced. This provides for certain unrealized gains and losses arising from changes in fair value to be temporarily recorded outside the Statement of Operations but in a transparent manner. The new standards are effective for the Corporation beginning January 1, 2007. The standards do not permit restatement of prior years financial statements, however, the standards have detailed transition provisions. As the Corporation has financial instruments, implementation planning will be necessary to review the new standards to determine the consequences for the Corporation. Accordingly, the Corporation has not yet evaluated all the consequences of the new standards, however, the adoption of the standards may have a material impact on the Corporation's Statement of Financial Position.

CRITICAL ACCOUNTING ESTIMATES

Critical accounting estimates are those that are most important to the portrayal of the Corporation's financial condition and results of operations. They require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Actual results could differ from those estimates under different assumptions or conditions.

The Corporation has identified the following areas that contain critical accounting estimates utilized in the preparation of its financial statements:

AIR TRANSPORTATION REVENUES

Airline passenger advance sales are deferred and included in current liabilities. Passenger revenues are recognized when the transportation is provided, except for revenues on unlimited flight passes which are recognized on a straight-line basis over the period during which the travel pass is valid. Due to the complex pricing structures, the complex nature of interline and other commercial agreements used throughout the industry, historical experience over a period of many years, and other factors including refunds, exchanges and unused tickets, certain amounts are recognized as revenue based on estimates. The Corporation performs regular evaluations on the deferred revenue liability which may result in adjustments being recognized as revenue. Events and circumstances may result in actual results that are different from estimates, however, these differences have historically not been material.

EMPLOYEE FUTURE BENEFITS

The significant policies related to employee future benefits, consistent with CICA 3461 – Employee Future Benefits, are as follows:

The cost of pensions and other post-retirement benefits earned by employees is actuarially determined using the projected benefit method prorated on service, market interest rates, and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.

A market-related value method is used to value plan assets for the purpose of calculating the expected return on plan assets. Under the selected method, the differences between investment returns during a given year and the expected investment returns are amortized on a straight-line basis over four years.

Past service costs arising from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. This period does not exceed the average remaining service period of such employees up to the full eligibility date.

Cumulative unrecognized net actuarial gains and losses in excess of 10 per cent of the greater of the projected benefit obligation or market-related value of plan assets at the beginning of the year are amortized over the remaining service period of active employees.

Management makes a number of assumptions in the calculation of both the accrued benefit obligation as well as the pension costs:

	September 30, 2004	December 31, 2004	December 31, 2005
Weighted average assumptions used to determine accrued benefit obligation			
Discount rate as at period end	6.00%	5.75%	5.00%
Rate of compensation increase	4.00%	4.00%	4.00%
Weighted average assumptions used to determine pension costs			
Discount rate as at period end	6.00%	6.00%	5.75%
Expected long term rate of return on plan assets	7.50%	7.50%	7.50%
Rate of compensation increase	4.00%	4.00%	4.00%

Discount rate

The discount rate used to determine the pension obligation was determined by reference to market interest rates on corporate bonds rated "AA" or better with cash flows that approximately match the timing and amount of expected benefit payments.

Expected Return on Assets Assumption

The Corporation's expected long-term rate of return on assets assumption is selected based on the facts and circumstances that exist as of the measurement date and the specific portfolio mix of plan assets. Management, in conjunction with its actuaries, reviews anticipated future long-term performance of individual asset categories and considers the asset allocation strategy adopted by the Corporation, including the longer duration in its bond portfolio in comparison to other pension plans. These factors are used to determine the average rate of expected return on the funds invested to provide for the pension plan benefits. While the review considers recent fund performance and historical returns, the assumption is primarily a long-term, prospective rate.

Asset Allocation

The actual and target allocations of the pension assets are as follows:

	December 31, 2004	November 30, 2005	Target Allocation
Equity	64.8%	62.3%	65.0%
Bonds and Mortgages	33.1%	32.1%	35.0%
Real Estate	0.2%	0.1%	0.0%
Short-term and Other	1.9%	5.5%	0.0%
Total	**100.0%**	**100.0%**	**100.0%**

Investment Policy

For the Domestic Registered Pension Plans, the investments conform to the Statement of Investment Policy and Objectives of the Air Canada Pension Master Trust Fund (Fund). The Audit, Finance and Risk Committee of the Board of Directors reviews and confirms the policy annually. The investment return objective of the Fund is to achieve a total annualized rate of return that exceeds inflation by at least 3.75 per cent over the long term. In addition to the broad asset allocation, as summarized in the asset allocation section above, the following policies apply to individual asset classes:

Equity investments can include convertible securities and are required to be diversified among industries and economic sectors. Foreign equities can comprise 27 to 33 per cent of the total market value of the trust. Limitations are placed on the overall allocation to any individual security at both cost and market value. Derivatives are permitted to the extent that they are not used for speculative purposes or to create leverage.

Fixed income investments are oriented toward risk averse, long-term, investment grade securities rated "A" or higher. With the exception of Government of Canada securities, or a province thereof, in which the plan may invest the entire fixed income allocation, fixed income investments are required to be diversified among individual securities and sectors. The target return is comprised of 50 per cent of the total return of the Scotia Capital Long Term Bond Index.

Best Estimate of Employer Contributions

Based upon an agreement, subject to approval of the Office of the Superintendent of Financial Institutions (Canada) (OSFI), between Air Canada and representatives of the unionized and non-unionized employees and retirees with respect to the funding of the Domestic Registered Plans, the estimated 2006 contributions are as follows:

($ millions)	2005 Contributions	2006 Contributions
Current service cost for Registered Pension Plans	133	139
Past service cost for Registered Pension Plans	99	198
Other pension arrangements	52	52
Total	**284**	**389**

Sensitivity Analysis

Sensitivity analysis on the 2005 pension expense based on different actuarial assumptions with respect to discount rate and expected return on plan assets is as follows:

Impact on 2005 pension expense ($ millions)	0.25 percentage point Decrease	0.25 percentage point Increase
Discount rate on obligation assumption	10	(10)
Long-term rate of return on plan assets assumption	23	(23)

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 10 per cent annual rate of increase in the per capita cost of covered health care benefits was assumed for 2005 (2004 - 10.75 per cent). The rate is assumed to decrease gradually to 5 per cent by 2013. A one percentage point increase in assumed health care trend rates would have increased the service and interest costs by $1 million and the obligation by $15 million. A one percentage point decrease in assumed health care trend rates would have decreased the service and interest costs by $1 million and the obligation by $20 million.

Upon emergence from CCAA, under fresh start reporting, all unamortized past service costs, net actuarial losses and net transition obligations, were written off and the Corporation recorded the estimated net accrued benefit obligations of the plans as at the date of emergence. At that time, all assumptions used in the calculations were revalidated.

LOYALTY PROGRAM

The Corporation's loyalty program, Aeroplan, awards mileage credits (Miles) to passengers who fly on Air Canada, Jazz, Star Alliance carriers and certain other airlines that participate in the program. Additionally, Aeroplan issues Miles to members for the purchase of goods and services from participating non-airline partners. The outstanding Miles may be redeemed for travel or other goods and services.

For additional information on the application of fresh start reporting and the change in accounting policy, refer to page 10 of this MD&A.

Based upon past experience, management anticipates that a number of Aeroplan Miles sold will never be redeemed by members. This is known as "breakage". For those Aeroplan Miles that Aeroplan does not expect will be redeemed by members, Aeroplan recognizes revenue on a straight-line basis over the average estimated life of an Aeroplan Mile, currently 30 months. The Corporation performs regular evaluations on the breakage estimate which may result in certain adjustments to revenues. During 2004, breakage was subject to a change in accounting estimate reducing it from 19 per cent to 17 per cent.

At December 31, 2005, the Corporation's estimated outstanding number of Miles was approximately 183 billion, as compared to substantially the same number at the end of the prior year. Management has recorded a liability of $1,633 million, including $680 million in Aeroplan deferred revenues, for the estimated number of Miles expected to be redeemed. A change to the estimate of Miles expected to be redeemed could have a significant impact on the liability in the period of change and in future periods.

In 2005, 52 billion Miles (2004 - 46 billion) were redeemed principally for travel. These redemptions represented approximately 10 per cent of Air Canada's total revenue passenger miles in 2005 (2004 - 10 per cent). Inventory controls over seat allocations keep displacement of revenue passengers to a minimum. Total Miles redeemed for travel on Air Canada in 2005, including awards and upgrades, represented 78 per cent of the total Miles redeemed, of which 60 per cent were used for travel within the US and Canada. In addition to the awards issued for travel on Air Canada, approximately 16 per cent of the total Miles redeemed in 2005 was used for travel on partner airlines and 6 per cent was used for goods and services from non-airline partners.

A change to either the redemption patterns of the Miles or the award options provided could have a significant impact on the Corporation's revenues in the year of change as well as in future years.

FUTURE INCOME TAXES

The Corporation utilizes the liability method of accounting for income taxes under which future income tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amount and the tax basis of assets and liabilities. Future income tax assets are recognized to the extent that realization is considered more likely than not. The Corporation considers past results, current trends and outlooks for future years in assessing realization of future income tax assets. The benefit of future income tax assets that existed at fresh start, and against which a valuation allowance is recorded, amounts to $2,334 million. This benefit will be recognized first to reduce to nil any remaining intangible assets (on a pro-rata basis) that were recorded upon fresh start reporting with any remaining amount as a credit to Shareholders' Equity.

IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets are tested for impairment whenever the circumstances indicate that the carrying value may not be recoverable by comparing the estimate of future expected cash flows to the carrying amount of the assets or groups of assets. If the carrying value is not recoverable from future expected cash flows, any loss is measured as the amount by which the asset's carrying value exceeds fair value. Recoverability is assessed relative to undiscounted cash flows from the direct use and disposition of the asset or group of assets, which requires management assumptions as to estimated future aircraft fair values and estimated net future cash flows from use of the aircraft.

PROPERTY AND EQUIPMENT

Property and equipment are originally recorded at cost. Property under capital leases and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of fair value of the property or equipment and the present value of those lease payments. Property and equipment are carried at the lesser of amortized cost and the net recoverable amount.

Property and equipment are depreciated to estimated residual values based on the straight-line method over their estimated service lives. Property and equipment under capital lease and variable interest entities are depreciated to estimated residual values over the life of the lease. Air Canada aircraft and flight equipment are depreciated over 20 to 25 years, with 10 to 15 per cent estimated residual values. Jazz aircraft and flight equipment are depreciated over 20 to 30 years, with 20 per cent estimated residual values. Aircraft reconfiguration costs are amortized over three years. Aircraft introduction costs are amortized over three years. Betterments to owned aircraft are capitalized and amortized over the remaining service life of the aircraft. Betterments to aircraft on operating leases are amortized over the term of the lease.

Buildings are depreciated over their useful lives not exceeding 50 years on a straight-line basis (30 years in the Predecessor Company). An exception to this is where the useful life of the building is greater than the term of the land lease. In these circumstances, the building is depreciated over the life of the lease. Leasehold improvements are amortized over the lesser of the lease term or five years. Ground equipment is depreciated over three to 25 years (five to 25 years in the Predecessor Company). Computer equipment is depreciated over three years (five years in the Predecessor Company).

Aircraft depreciable life is determined through economic analysis, a review of existing fleet plans and comparisons to other airlines operating similar fleet types. Residual values are estimated based on Air Canada's historical experience with regard to the sale of both aircraft and spare parts, as well as future-based valuations prepared by independent third parties.

INTANGIBLE ASSETS

The identifiable intangible assets of the Corporation were fair valued-based on valuation techniques for the purpose of financial reporting under fresh start reporting requirements as at September 30, 2004. The indefinite lives of the intangible assets recorded by the Corporation are significant and are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. In addition, the Corporation is required to assess the remaining life of amortizable assets on a regular basis.

Fair value under Canadian GAAP is defined as "the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act". Assessing the fair value of intangible assets requires significant management estimates on future cash flows to be generated by the assets, including the estimated useful life of the assets.

SENSITIVITY OF CONSOLIDATED RESULTS

Financial results of the Corporation are subject to many different internal and external factors which can have a significant impact on operating results. In order to provide a general guideline, the following table describes, on an indicative basis, the financial impact that changes in operating assumptions would generally have had on the consolidated 2005 operating results. These guidelines were derived from 2005 levels of activity and make use of management estimates. The impacts are not additive, do not reflect the interdependent relationship of the elements and may vary significantly from actual results due to factors beyond the control of the Corporation. Conversely, an opposite change in the sensitivity factor would have had the opposite effect on operating income.

Key Variable	Routes	2005 Measure	Sensitivity factor	Estimated Operating Income Impact
Revenue Measures				($ millions)
Passenger yield(cents) (including Aeroplan)	System	17.6	1% change in yield	78
	Canada	23.1		32
Traffic (RPMs) (millions)	System	46,764	1% change in traffic	71
	Canada	14,916		29
Passenger load factor	System	79.5	1 percentage point change	89
RASM (cents) (including Aeroplan)	System	14.0	1% change in RASM	74
Cost Measures				
Labour and benefits expenses ($ millions)		2,520	1% change	25
Fuel – WTI price (US$/barrel)		55.33	US$1/barrel change(1) to WTI	31
Fuel – jet fuel price (cents/litre)		59.39	1% change(1)	22
Cost per ASM (cents)		15.9	1% change	94

(1) Excludes impact of fuel surcharges and fuel hedging.

Key Variable	2005 Measure	Sensitivity factor	Estimated Operating Income Impact	Estimated Pre-Tax Income Impact
Currency Exchange			($ millions)	($ millions)
Canada to US ($)	1.21	1 cent change (e.g. $1.21 to $1.20)	11	39

RISK FACTORS

The risk factors described herein may not be exhaustive. The Corporation operates under frequently shifting business environments and new risk factors may develop. The Corporation cannot forecast new risk factors, nor can it estimate the effect, if any, that such new risk factors may have on its businesses or the extent to which any factor or combination of factors may impact the Corporation's business.

RISKS RELATING TO THE CORPORATION

OPERATING RESULTS

The Predecessor Company sustained significant operating losses and the Corporation may sustain significant losses in the future. The Predecessor Company emerged from protection under the CCAA and implemented the consolidated plan of reorganization, compromise and arrangement (the Plan) on September 30, 2004. Although the Corporation has been successful in reducing its operating costs and is pursuing additional measures to further lower its costs and to offset record high fuel expenses, the Corporation may not be able to effectively achieve or maintain anticipated planned cost reductions or maintain and restore positive net profitability.

LEVERAGE AND LIQUIDITY

The Corporation has, and will continue to have, a significant amount of indebtedness, including fixed obligations under aircraft leases as outlined in the Debt an Lease Obligations section of this MD&A. The Corporation may incur additional debt, including secured debt, in the future. The amount of indebtedness that the Corporation incurs could have important consequences. For example, it could (i) limit the Corporation's ability to obtain additional financing for working capital, capital expenditures, acquisitions and general corporate purposes, (ii) require the Corporation to dedicate a substantial portion of its cash flow from operations to payments on its indebtedness, thereby reducing the funds available for other purposes, (iii) make the Corporation more vulnerable to economic downturns, (iv) limit its ability to withstand competitive pressures and reduce its flexibility in responding to changing business and economic conditions and, (v) limit the Corporation's flexibility in planning for, or reacting to, changes in its businesses and the industries in which it operates.

LIMITATIONS DUE TO RESTRICTIVE COVENANTS

Some of the financing arrangements entered into by the Corporation contain restrictive covenants which affect and, in some cases, significantly limit or prohibit, among other things, the Corporation's ability to incur indebtedness, create liens, sell assets, make capital expenditures and engage in acquisitions, mergers, amalgamations and consolidations. In addition, certain financing arrangements require the Corporation to maintain financial ratios. Any future borrowings may also be subject to covenants which limit the Corporation's operating and financial flexibility, which could materially and adversely affect the Corporation's profitability. If the Corporation fails to comply with the various covenants of its indebtedness, it may be in default under the terms thereof, which would permit holders of such indebtedness to exercise certain rights, which may include accelerating the maturity of such indebtedness, and, such defaults could cause defaults under other indebtedness or agreements. In such circumstances, the lenders under the financing arrangements could foreclose upon all or substantially all of the assets of the Corporation which secure the obligations of the Corporation.

The ability of the Corporation to make scheduled payments under its indebtedness will depend on, among other things, its future operating performance and its ability to refinance its indebtedness when necessary. Each of these factors is to a large extent subject to economic, financial, competitive, regulatory, operational and other factors, many of which are beyond the Corporation's control. There can be no assurance that the Corporation will be able to generate sufficient cash from its operations to pay its debts and lease obligations.

NEED FOR ADDITIONAL CAPITAL

The Corporation is facing a number of challenges in its current business operations, including high fuel prices and continued intense competition from US transborder and low-cost domestic carriers. There can be no assurance that the Corporation will continue to be able to obtain on a timely basis sufficient funds on terms acceptable to the Corporation to provide adequate liquidity and to finance the operating and capital expenditures necessary to implement its new business strategy if cash flow from operations and cash on hand are insufficient.

Failure to generate additional funds, whether from operations or additional debt or equity financings, may require the Corporation to delay or abandon some or all of its anticipated expenditures or to modify its new business strategy, which could have a material adverse effect on the Corporation's business, results from operations and financial condition. Furthermore, the ability of competitors to raise money more easily and on less onerous terms could create a competitive disadvantage for the Corporation.

In addition, the Corporation's credit ratings influence its ability to access capital markets. There can be no assurance that the Corporation's credit ratings will not be downgraded, which may add to the Corporation's borrowing and insurance costs, hamper its ability to attract capital and limit its ability to operate its business, all of which could have a material adverse effect on the Corporation's business, results from operations and financial condition.

DEPENDENCE UPON SUBSIDIARIES

ACE is a holding company with no material sources of income, operations or assets of its own other than the cash resources it holds totaling approximately $400 million at December 31, 2005, the interest that it has in its subsidiaries and the distributions it receives from its retained interests in Aeroplan and Jazz. The Corporation is entirely dependent on the operations and assets of its subsidiaries. Any possible declaration of dividends by the Corporation to its shareholders will be dependent on the ability of its subsidiaries to declare dividends or make other payments or advances to the Corporation, or the sale by the Corporation of its interest in its subsidiaries including its retained interests in Aeroplan and Jazz. The ability of the Corporation's subsidiaries to make distributions or other payments or advances will be subject to applicable laws and regulations and contractual restrictions that may be contained in the instruments governing any indebtedness of those entities. In addition, any right of the Corporation to receive assets of its subsidiaries upon their liquidation or reorganization will be structurally subordinated to the prior claims of creditors of such subsidiaries.

AIRCRAFT FLEET

A key component of the Corporation's business plan is the restructuring of its aircraft fleet, including the elimination and replacement of older, less efficient aircraft, the introduction of new regional jet aircraft (deliveries of which began in the fourth quarter of 2004), and the modernization of its international widebody fleet through the acquisition of new more economically efficient aircraft. With respect to the new regional jet aircraft, the Corporation's focus is on high frequency on key domestic and US transborder routes, while maintaining frequency on other domestic and US transborder routes through the increased use of large regional jet aircraft with lower trip costs in order to better match capacity with demand. Management expects that these regional jet aircraft will enable Air Canada to compete more effectively with low-cost carriers. Through the international widebody aircraft fleet renewal, management expects that these aircraft will allow Air Canada to place itself in a leadership position among North American international airlines and enable the airline to compete more effectively alongside the leading European, Middle East and Pacific carriers. A delay or failure in the completion of the Corporation's fleet restructuring, including a delay in delivery of the regional jet and widebody aircraft, or an inability to remove, as planned, certain widebody aircraft from the fleet in coordination with the planned entry into service of new widebody aircraft, could adversely affect the implementation of the Corporation's business plan which may, in turn, have a material adverse effect on the Corporation's business, results from operations and financial condition.

KEY PERSONNEL

The Corporation is dependent on the experience and industry knowledge of its executive officers and other key employees to execute its business plans. If the Corporation were to experience a substantial turnover in its leadership or other key employees, the Corporation's business, results from operations and financial condition could be materially adversely affected. Additionally, the Corporation may be unable to attract and retain additional qualified key personnel as needed in the future.

EMPLOYEE RELATIONS

Most of the Corporation's employees are unionized and new or modified collective agreements were concluded during the Predecessor Company's CCAA restructuring with each of the bargaining agents. The collective agreements permit bargaining on wages in 2006 but no strikes or lock-outs may lawfully occur until after the agreements expire in 2009. Despite this, there can be no assurance that there will not be a labour conflict that could lead to an interruption or stoppage in service at key airports. Any labour conflicts could have a material adverse effect on the Corporation's business, results from operations and financial condition. In addition, labour problems at Air Canada's Star Alliance partners, including Lufthansa and United Airlines, could result in lower demand for connecting traffic with Air Canada and, ultimately, could have a material adverse effect on the Corporation's business, results from operations and financial condition.

KEY SUPPLIERS

The Corporation's business is significantly dependent upon its ability to secure goods and services from a number of key suppliers, such as those relating to fuel and other key goods and services. An interruption in the provision of goods or services from a key supplier could have a material adverse impact on the Corporation's business, results from operations and financial condition. Such interruptions or stoppages may arise from a wide range of factors, including labour disputes and other factors, many of which are beyond the Corporation's control.

INTERRUPTIONS OR DISRUPTIONS IN SERVICE

The Corporation's business is significantly dependent upon its ability to operate without interruption at a number of key airports, including Pearson Airport. An interruption or stoppage in service at a key airport could have a material adverse impact on the Corporation's business, results from operations and financial condition.

DEPENDENCE ON TECHNOLOGY

The Corporation relies in part on technology, including computer and telecommunications equipment and software and Internet-based commerce, to operate its business, including to increase revenues and to reduce costs. Proper implementation and operation of required technology initiatives is fundamental to the Corporation's ability to operate a profitable business. The Corporation continually invests in new technology initiatives to operate its business and remain competitive, and its continued ability to invest sufficient amounts in required technology initiatives is important to maintain the Corporation's ability to operate successfully. A failure or inability to invest in required technology initiatives could have a material adverse effect on the Corporation's business, results from operations and financial condition.

The technology systems of the Corporation, including computer and telecommunications equipment and software and Internet-based technology systems, may be vulnerable to a variety of sources of failure, interruption or misuse, including natural disasters, terrorist attacks, telecommunications failures, power failures, computer viruses, hackers, unauthorized or fraudulent users, and other security issues. While the Corporation continues to invest in technology security initiatives and disaster recovery plans, these measures may not be adequate or implemented properly. Any such occurrence or event, including by reason of power, telecommunication or Internet interruptions, could materially and adversely affect the Corporation's operations and could have a material adverse effect on the Corporation's business, results from operations and financial condition.

PENSION PLANS

Canadian federal pension legislation requires that the funded status of registered pension plans be determined periodically, on both a going concern basis (i.e., essentially assuming indefinite plan continuation) and a solvency basis (i.e., essentially assuming immediate plan termination).

The solvency liability is influenced primarily by long-term interest rates and by the investment return on plan assets. The interest rate used to calculate benefit obligations for solvency purposes is a prescribed rate derived from the interest rates on long-term Government of Canada bonds. In the current low interest rate environment, the calculation results in a higher present value of the pension obligations, leading to a larger unfunded solvency position.

In May 2004, the Corporation and OSFI agreed on a protocol pursuant to which the solvency funding requirements for the Corporation's registered pension plans provided for in the then existing regulations were amended retroactive to January 1, 2004. The Corporation will have to make substantial annual cash contributions, and the level of those contributions will increase in the event of poor pension fund investment performance and/or further declines in long-term Government of Canada bond rates.

FEDERAL COURT OF APPEAL JUDGMENT - EQUAL PAY LITIGATION

The flight attendants union at Air Canada has two complaints before the Canadian Human Rights Commission in which it alleges gender-based wage discrimination. The Canadian Union of Public Employees claims the predominantly female flight attendant group should be paid the same as the predominantly male pilot and mechanics groups because their work is of equal value. The complaints date from 1991 and 1992, but have not been investigated because of a legal dispute over whether the three groups work in the same "establishment" within the meaning of the Canadian Human Rights Act (the Act). On January 26, 2006, the Supreme Court of Canada ruled that they do, and remitted the case to the Commission, which may now proceed to assess the value of each group's work.

During the restructuring under CCAA, it was agreed that any resolution of the complaints would have no retroactive financial impact prior to September 30, 2004. It is the view of Air Canada that any investigation will show that it is complying with the equal pay provisions of the Act. Nonetheless, should these complaints succeed, the accrued liability and future costs could be very significant and the Corporation's business, results from operations and financial condition could be materially adversely affected.

STAR ALLIANCE

The strategic and commercial arrangements with Star Alliance members provide Air Canada with important benefits, including codesharing, efficient connections and transfers, reciprocal participation in frequent flyer programs and use of airport lounges from the other members. Should a key member leave the Star Alliance or otherwise be unable to meet its obligations hereunder, the Corporation's business, results from operations and financial condition could be materially adversely affected.

FOREIGN EXCHANGE

The Corporation's financial results are sensitive to the changing value of the Canadian dollar. In particular, the Corporation has a significant annual net outflow of US dollars and is affected by fluctuations in the Canada/US dollar exchange rate. The Corporation estimates that during 2005, a $0.01 increase in the Canada/US dollar exchange rate (i.e. from $1.20 to $1.21 per US dollar) would have had an estimated $11 million unfavourable impact on operating income and an estimated $39 million unfavourable impact on pre-tax income. Conversely, an opposite change in the exchange rate would have had the opposite effect on operating income. The Corporation incurs significant expenses in US dollars for such items as fuel, aircraft rental charges, interest payments, debt servicing and computerized reservations system fees, while a substantial portion of its revenues are generated in Canadian dollars. A significant deterioration of the Canadian dollar relative to the US dollar would increase the costs of the Corporation relative to its US competitors and could have a material adverse effect on the Corporation's business, results from operations and financial condition.

BUSINESS INITIATIVES

The Corporation aggressively identifies and pursues important and innovative initiatives in the course of operating its business. Proper planning and implementation of these initiatives is important to the Corporation's profitability. There can be no assurance that these initiatives will be successfully implemented or achieve expected results. A failure to successfully implement such initiatives could have a material adverse effect on the Corporation's business, results from operations and financial condition.

RISKS RELATING TO THE INDUSTRY

COMPETITION

Air Canada operates within a highly competitive industry. Over the past few years, several carriers have entered or announced their intent to enter into domestic and US transborder markets in which Air Canada operates.

Canadian low-cost airlines have significantly expanded in many of Air Canada's key domestic markets and have entered the US transborder market as well. Canjet operates flights to New York and Florida (during the winter) and WestJet provides regular scheduled service to Nevada, Hawaii, Florida, California, New York and Arizona. In February 2006, Porter Airlines announced its intent to offer short-haul flights from Toronto Island Airport to Canadian and US cities using 70-seat Q400 Bombardier turboprop aircraft.

If these carriers are successful in entering or continuing their expansion into the domestic and US transborder markets of Air Canada, the Corporation's business, financial condition and results from operations could be materially adversely affected.

US carriers currently operate routes in Air Canada's transborder market. If additional US carriers were to enter Air Canada's transborder market, or if US carriers were to introduce additional transborder services, this could have a material adverse effect on the Corporation's business, results from operations and financial condition.

The Corporation is also facing increasing competition in international markets as carriers increase their international capacity, both by expansion and by shifting existing domestic capacity to international operations to avoid low-cost domestic competition. If these carriers are successful in their expansion in the international markets, or if other carriers enter Air Canada's markets, the Corporation's business, financial condition and results from operations could be materially adversely affected.

The Corporation also encounters substantial price competition. The expansion of low-cost carriers in recent years has resulted in a substantial increase in discounted and promotional fares initiated by competitors. The decision to match competitors' fares, to maintain passenger traffic, results in reduced yields which, in turn, could have a material adverse effect on the Corporation's business, results from operations and financial condition. Furthermore, the Corporation's ability to reduce Air Canada's fares in order to effectively compete with other carriers may be limited by government policies to encourage competition. Such government policies could have a material adverse effect on the Corporation's business, results from operations and financial condition.

Internet travel websites have driven significant distribution cost savings for airlines, but have also enabled consumers to more efficiently find lower fare alternatives by providing them with access to more pricing information. The increased price awareness of both business and leisure travelers as well as the growth in new distribution channels have further motivated airlines to price aggressively to gain fare and market share advantages. These factors will increase over time as Internet ticket sales increase, which will reduce yields and, in turn, could have a material adverse effect on the Corporation's business, results from operations and financial condition.

AIRLINE REORGANIZATIONS

Since September 11, 2001, a number of US air carriers have sought to reorganize under Chapter 11 of the United States Bankruptcy Code. Successful completion of such reorganizations (such as the successful emergence of US Airways and its merger with America West as well as the expected emergence of United Airlines) could present the Corporation with competitors having reduced levels of indebtedness and significantly lower operating costs derived from labour, supply and financing contracts that were renegotiated under the protections of the Bankruptcy Code. In addition, air carriers involved in reorganizations historically have undertaken substantial fare discounting in order to maintain cash flows and to enhance continued customer loyalty. Such fare discounting could result in lower yields for the Corporation which, in turn, could have a material adverse effect on the Corporation's business, results from operations and financial condition.

ECONOMIC AND GEOPOLITICAL CONDITIONS

Airline operating results are sensitive to economic and geopolitical conditions which have a significant impact on the demand for air transportation. Airline fares and passenger demand have fluctuated significantly in the past and may fluctuate significantly in the future. The Corporation is not able to predict with certainty market conditions and the fares Air Canada and Jazz will be able to charge. Customer expectations are changing rapidly and the demand for lower fares may limit revenue opportunities. A downturn in economic growth in North America, as well as geopolitical instability in various areas of the world, would have the effect of reducing demand for air travel in Canada and abroad and, together with the other factors discussed herein, could materially adversely impact the Corporation's profitability. Any prolonged or significant weakness of the Canadian and world economy could have a material adverse effect on the Corporation's business, results from operations and financial condition, especially given the Corporation's substantial fixed cost structure.

AIRLINE INDUSTRY CHARACTERIZED BY LOW GROSS PROFIT MARGINS AND HIGH FIXED COSTS

The entire airline industry and scheduled service in particular are characterized by low gross profit margins and high fixed costs. The costs of operating each flight do not vary significantly with the number of passengers carried and, therefore, a relatively small change in the number of passengers or in fare pricing or traffic mix could, in the aggregate, have a significant effect on the Corporation's operating and financial results. This condition has been exacerbated by aggressive pricing by low-cost carriers, which has had the effect of driving down airline fares in general. Accordingly, a minor shortfall from expected revenue levels could have a material adverse effect on the Corporation's business, results from operations and financial condition.

DEPENDENCE OF OTHER OPERATING ENTITIES

Many of the risk factors in the nature of those described herein, should they materialize, could have a material adverse effect on the Corporation's other operating entities, including Air Canada, Air Canada Cargo, ACGHS, Jazz, ACTS and Aeroplan, either directly, or indirectly, by affecting the air transportation industry generally and/or other air carriers, on which these other operating entities rely for the success of their business, results from operations and financial condition.

FUEL COSTS

Fuel costs were the second largest expense to the Corporation in 2005. Fuel prices fluctuate widely depending on many factors including international market conditions, geopolitical events and the Canada/US dollar exchange rate. The Corporation cannot accurately predict fuel prices. During 2003, 2004 and 2005, fuel prices increased and currently remain at historically high levels. Should fuel prices continue at, or continue to increase above, such high levels, fuel costs could have a material adverse impact on

the Corporation's business, results from operations and financial condition. Due to the competitive nature of the airline industry, the Corporation may not be able to pass on any increases in fuel prices to its customers by increasing its fares. Based on 2005 volumes, the Corporation estimates that a US$1 per barrel movement in the average price of West Texas Intermediate (WTI) crude oil would have resulted in an approximate $31 million change in 2005 fuel expense for Air Canada (excluding any impact of fuel surcharges and fuel hedging), assuming flying capacity remained unchanged and that refining spreads between WTI crude oil and jet fuel as well as foreign exchange rates remained constant.

In order to help 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, beginning in September 2005, for a 24-month period.

TERRORIST ATTACKS

The September 11, 2001 terrorist attacks and subsequent terrorist attacks, notably in the Middle East, Southeast Asia and Europe, caused uncertainty in the minds of the traveling public. The occurrence of a major terrorist attack (whether domestic or international and whether involving the Corporation or another carrier) could have a material adverse effect on passenger demand for air travel and on the number of passengers traveling on Air Canada's flights. It could also lead to a substantial increase in insurance and airport security costs. Any resulting reduction in passenger revenues and/or increases in insurance and security costs could have a material adverse impact on the Corporation's business, results from operations and financial condition.

EPIDEMIC DISEASES (SEVERE ACUTE RESPIRATORY SYNDROME, AVIAN FLU OR OTHER DISEASES)

As a result of the international outbreaks of Severe Acute Respiratory Syndrome (SARS) in 2003, the World Health Organization (WHO) issued on April 23, 2003 a travel advisory, which was subsequently lifted on April 30, 2003, against non-essential travel to Toronto, Canada. The WHO travel advisory relating to Toronto, the location of Air Canada's primary hub, and the international SARS outbreak had a significant adverse effect on passenger demand for air travel destinations served by Air Canada and Jazz, and on the number of passengers traveling on Air Canada's and Jazz's flights and resulted in a major negative impact on traffic on the entire network. A further outbreak of SARS or of another epidemic disease (whether domestic or international) or a further WHO travel advisory (whether relating to Canadian cities or regions or other cities, regions or countries) could have a material adverse effect on passenger demand for air travel and on the number of passengers traveling on Air Canada's and Jazz's flights. Any resulting reduction in traffic on Air Canada's and Jazz's network could have a material adverse effect on the Corporation's business, results from operations and financial condition.

SEASONAL NATURE OF THE BUSINESS, OTHER FACTORS AND PRIOR PERFORMANCE

Air Canada 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.

As described elsewhere, demand for air travel is also affected by factors such as economic conditions, war or the threat of war, fare levels and weather conditions. Due to these and other factors, operating results for an interim period are not necessarily indicative of operating results for an entire year, and operating results for a historical period are not necessarily indicative of operating results for a future period.

REGULATORY MATTERS

The airline industry is subject to extensive Canadian and foreign government regulations relating to, among other things, security, safety, licensing, competition, noise levels and the environment. Additional laws and regulations may be proposed from time to time which could impose additional requirements or restrictions on airline operations. The implementation of additional limitations by governments, the Competition Bureau and/or the Competition Tribunal or other governmental entities may have a material adverse effect on the Corporation's business, results from operations and financial condition. The Corporation cannot give any assurances that new regulations or revisions to the existing regulations will not be adopted. The adoption of such new regulations or revisions could be materially adverse to the Corporation's business, results from operations and financial condition.

The availability of international routes to domestic air carriers is regulated by agreements between Canada and foreign governments. Changes in Canadian or foreign government aviation policy could result in the alteration or termination of these agreements and could adversely affect the Corporation's international operations.

In July 2000, the Government of Canada amended the Canada Transportation Act (CTA), the Competition Act and the Air Canada Public Participation Act (Canada) to address the competitive airline environment in Canada and ensure protection for consumers. This legislation increased the powers of the CTA with respect to pricing on non-competitive domestic routes, and domestic terms and conditions of carriage.

This legislation also included airline specific provisions concerning "abuse of dominance" under the Competition Act, including the establishment of administrative monetary penalties for a breach of the "abuse of dominance" provision by a dominant domestic air carrier. In February 2001, the Competition Bureau released for consultation draft guidelines outlining the approach it proposed to take in enforcing the airline specific "abuse of dominance" provisions of the Competition Act.

In March 2001, the Commissioner of Competition brought an application under the "abuse of dominance" provisions of the Competition Act, seeking an order prohibiting Air Canada from charging fares on flights on certain routes in eastern Canada if such fares would not cover the avoidable costs of such flights. By agreement of Air Canada and the Commissioner of Competition, the application was divided into two phases, Phase I of which considered the approach to be taken in reviewing an avoidable cost case against Air Canada. The Competition Tribunal released its reasons and findings regarding Phase I on July 22, 2003, and adopted a broadly crafted avoidable cost test. The decision of the Competition Tribunal does not constitute a determination that Air Canada breached the Competition Act by abusing its dominant position, which is an issue that would have been determined in Phase II of the application.

In September 2004, following extensive discussions with Air Canada about resolving the tribunal case and related issues, the Commissioner of Competition issued a letter describing the enforcement approach to be taken by the Competition Bureau to any new complaint made against a dominant domestic carrier in light of the changes in the airline industry that have occurred since 2000. The Commissioner has also indicated support for the repeal of the airline specific provisions at the Competition Act, although the timing for such legislative changes is unknown given the recent change in the federal government following the January 23, 2006 elections.

In light of these developments, and as part of the agreement to terminate the application to the Competition Tribunal, Air Canada determined that it would not appeal the Competition Tribunal's decision in Phase I of the application. The Competition Bureau has expressed its view that the principles established by the Competition Tribunal in Phase I of the application regarding the application of the avoidable cost test would be relevant for any future cases which may arise in similar circumstances. If the Commissioner of Competition commences inquiries or brings similar applications with respect to significant competitive domestic routes and such applications are successful, it could have a material adverse effect on the Corporation's business, results from operations and financial condition.

The Corporation is subject to domestic and foreign laws regarding privacy of passenger and employee data that are not consistent in all countries in which the Corporation operates. In addition to the heightened level of concern regarding privacy of passenger data in Canada, certain US and European government agencies are initiating inquiries into airline privacy practices. Compliance with these regulatory regimes is expected to result in additional operating costs and could have a material adverse effect on the Corporation's business, results from operations and financial condition.

INCREASED INSURANCE COSTS

The terrorist attacks of September 11, 2001 (9/11), and the resulting staggering losses to the insurance industry, led to a significant increase in Air Canada's insurance premiums. While this premium increase has steadily decreased since 9/11, premiums have not returned to pre 9/11 levels and continue to negatively impact the financial results of the Corporation. In addition, the aviation insurance industry is continually reevaluating the terrorism risks that they do cover and this activity may adversely affect some of the Corporation's existing insurance carriers or the Corporation's ability to obtain future insurance coverage. To the extent that the Corporation's existing insurance carriers are unable or unwilling to provide it with insurance coverage, the Corporation's insurance costs may increase further and may result in the Corporation being in breach of contractual arrangements requiring that specific insurance be maintained, which may have a material adverse effect on the Corporation's business, results from operations and financial condition.

THIRD PARTY WAR RISK INSURANCE

There is a risk that the Government of Canada may not continue to provide an indemnity for third party war risk liability coverage, which it is currently providing to the Corporation and certain other carriers in Canada. In the event that the Government of Canada does not continue to provide such indemnity or amends such indemnity, the Corporation and other industry participants would have to turn to the commercial insurance market to seek such coverage. Such coverage would cost the Corporation in excess of $24 million per year. Alternative solutions, such as that envisioned by the International Civil Aviation Organization (ICAO) and the International Air Transport Association (IATA), have not developed as planned, due to actions taken by other countries and the recent availability of supplemental insurance products. ICAO and IATA are continuing their efforts in this area, however, the prospects for a global solution are not in the immediate or near future. The US federal government has set up its own facility to provide war risk coverage to US carriers, thus removing itself as a key component of any global plan.

Furthermore, the London aviation insurance market has introduced a new standard war and terrorism exclusion clause to apply to aircraft hull and spares war risk insurance, and intends to introduce similar exclusions to airline passenger and third party liability policies, that excludes claims caused by the hostile use of a dirty bomb, electromagnetic pulse device, or biochemical materials. The Government of Canada indemnity program is designed to address these types of issues as they arise, but it has not yet decided to extend the indemnity to cover this exclusion. Unless and until the Government of Canada does so, the loss of coverage exposes the Corporation to this new uninsured risk and may ultimately result in the Corporation being in breach of contractual arrangements, which may have a material adverse effect on the Corporation's business, results from operations and financial condition.

CASUALTY LOSSES

Due to the nature of its core operating business, the Corporation may be subject to liability claims arising out of accidents or disasters involving aircraft on which the Corporation's customers are traveling or involving aircraft of other carriers maintained or repaired by the Corporation, including claims for serious personal injury or death. There can be no assurance that the Corporation's insurance coverage will be sufficient to cover one or more large claims and any shortfall may be material. Additionally, any accident or disaster involving one of the Corporation's aircraft or an aircraft of another carrier maintained or repaired by the Corporation may significantly harm the Corporation's reputation for safety, which would have a material adverse effect on the Corporation's business, results from operations and financial condition.

AIRPORT USER FEES AND AIR NAVIGATION FEES

With the privatization of airports over the last several years in Canada, new airport authorities have imposed significant increases in airport user fees. If airport authorities continue to increase their fees at the rate at which they have increased them in the recent past, the Corporation's business, results from operations and financial condition could be materially adversely affected.

CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures within the Corporation are designed to provide reasonable assurance that all relevant information is identified to its Disclosure Policy Committee to ensure appropriate and timely decisions are made regarding public disclosure.

An evaluation of the effectiveness of the Corporation's disclosure controls and procedures, as defined under the rules of the Canadian Securities Administration (CSA) and the Securities and Exchange Commission (SEC), was conducted at December 31, 2005 by and under the Corporation's management, including the Chief Executive Officer and the Chief Financial Officer. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Corporation's disclosure controls and procedures are effective.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of the Corporation's financial reporting and compliance with generally accepted accounting principles in its financial statements.

The Corporation's management have evaluated whether there were changes to its internal controls over financial reporting during the year ended December 31, 2005 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting. No such changes were identified through management's evaluation.

OUTLOOK

Over the past two years, the Corporation has implemented a new business model, restructured its operations, improved employee and asset productivity, reduced operating costs and established a new corporate and capital structure with reduced financial leverage. This has resulted in improved financial results and competitive position.

The Corporation is committed in 2006 to deliver its business plan including continued expansion of the new business model and improved cost and productivity through process re-design and technological enhancements. Key pillars of the 2006 plan are to:

- grow revenues and customer loyalty, through further enhancement of the new business model including expansion of the subscription pass product;
- deliver a superior customer experience with new aircraft and significantly improved in-flight product;
- improve customer access to products and business unit productivity through simplifying processes, technology and process re-design;
- improve labour relations and employee involvement;
- enhance shareholder value through expansion of key businesses and potential monetization.

TRANSPORTATION SERVICES

The airline business, in 2006, plans to increase its system ASM flying capacity by approximately 5 per cent compared to 2005. With the introduction of large regional jets, North American operations are expected to grow by approximately 7 per cent with greater point-to-point services. Jazz flying, in terms of ASMs, is planned to increase by over 50 per cent from the prior year in order to benefit from the lower operating costs of this business segment.

Low-cost carriers have achieved success in the North American market and a number of legacy carriers have or are in the process of restructuring their operations to lower costs and improve their competitive position. As a result, passenger fares and yields per RPM are expected to remain under pressure in 2006. Over the past 21 months, the Corporation has achieved record load factors with the successful implementation of its new business model. Load factors are expected to remain high in 2006, however, they may not continue at record levels. With competitively priced passenger fares, operating higher load factors enables greater revenue generation per flight and higher efficiency of ground and support operations.

The new Bombardier and Embraer regional jets allow the Corporation to offer greater aircraft frequencies and operate more profitably on specific routes with relatively fewer passengers per flight as compared to larger aircraft operated by either Air Canada or its low-cost carrier competition. Deliveries of the new Embraer 190 aircraft continue in 2006 and 45 of these aircraft are expected to be in service by early 2008. With these new aircraft, the Corporation is progressively expanding its point-to-point network to enhance its ability to compete with low-cost carriers operating larger aircraft on specific routes.

A cornerstone of the Corporation's strategy going forward will be the growth of its international operations. In order to support the expansion of these operations and deliver a superior customer product, the Corporation will be taking delivery of new Boeing 777 series aircraft beginning in 2007 and the highly efficient Boeing 787 aircraft commencing in 2010.

The airline industry is subject to numerous factors and costs over which it has little or no control (more fully described in the Risk Factors section). These include crude oil and jet fuel prices and quasi-government or airport authority fees for airport or navigation charges amongst others. With crude oil prices trading in the record US$65-70 range and refining spreads subject to continuing volatility, fuel expense remains a major risk in 2006. The Corporation has progressively implemented fuel hedging in 2005 and has been able to mitigate a portion of previous fuel price increases through higher passenger and cargo charges. However, the pricing of crude oil and jet fuel is subject to market forces and it is not certain whether the Corporation will be able to mitigate, in a meaningful way, continuing record fuel prices in a highly competitive airline environment. 2005 saw major increases in airport fees especially at its main hub in Toronto. Further increases were implemented in 2006, but at a lower rate than in 2005. Nonetheless, these costs will continue to increase during the year.

In 2006, the Corporation has a wage review covering most of its unionized employees under the collective agreements which expire in 2009.

AEROPLAN

In 2006, Aeroplan will further enhance its partnerships and value-added services, as well as remain favourable to strategic acquisition opportunities, while sustaining a meaningful distributable cash growth.

It will also pursue further cost reductions and efficiency gains in operations, particularly with respect to call centre productivity improvements and use of web-based service products. New practices, such as work-at-home for the call centre agents, will also be investigated.

JAZZ

The recent Jazz public offering is in support of ACE's value enhancement strategy. Management remains fully committed to delivering continued improvements in financial and operational results in the future.

By July 2006, Jazz's operating fleet is scheduled to reach 135 aircraft.

Effective January 1, 2006, an amended and restated capacity purchase agreement with Air Canada, the CPA, will, among other things, establish the rates to be paid by Air Canada to Jazz for 2006 through 2008 and the minimum number of covered aircraft until December 2015. Management anticipates that substantially all of Jazz's currently contemplated growth will be attributable to the CPA with Air Canada and the increased fleet contemplated by such agreement.

ACTS

As it begins its second full year as a stand-alone organization, ACTS will continue to work on developing its business model and will focus on its operations and productivity to improve financial results.

Increased productivity, enhanced processes and systems, cost improvement and sustainable growth will be ACTS' priorities in 2006. In addition, ACTS will continue to focus on meeting customer production requirements.

SUBSEQUENT EVENTS

JAZZ AIR INCOME FUND

On February 2, 2006, the Jazz Air Income Fund (the Fund) sold 23.5 million units at a price of $10 per unit for net proceeds of approximately $222 million. The Fund is an unincorporated, open-ended trust created to indirectly acquire and hold 19.1 per cent of the outstanding limited partnership units of Jazz. ACE holds the remaining 80.9 per cent of the outstanding limited partnership units of Jazz.

The Fund has granted to the underwriters an over-allotment option (the Over-Allotment Option), exercisable for a period of 30 days following the Closing Date, to purchase up to 3.525 million additional units at $10 per unit for net proceeds of $33 million. In the event the underwriters exercise the Over-Allotment Option in full, the Fund and ACE will hold 22 per cent and 78 per cent of the outstanding limited partnership units of Jazz respectively.

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

In connection with the offering, the establishment of $150 million senior secured syndicated credit facilities was completed. On closing of the offering, $115 million was drawn under the credit facilities. The facility bears interest at floating rates and has a three-year term.

NON-UNIONIZED LABOUR REDUCTIONS

In February 2006, the Corporation announced that certain ACE companies will proceed with the reduction of non-unionized staffing levels by 20 per cent. The non-unionized staff reductions are expected to take place primarily at Air Canada, Air Canada Cargo, ACGHS and ACTS. The costs of this program will be recorded during the first quarter of 2006 once the details of the plan are finalized.

MANAGEMENT'S REPORT

The consolidated financial statements have been prepared by management. Management is responsible for the fair presentation in the consolidated financial statements of financial position, results of operations and cash flows in conformity with generally accepted accounting principles. Management is also responsible for all other financial information included in the annual report and for ensuring that this information is consistent, where appropriate, with the information and data contained in the financial statements.

In support of its responsibility, management maintains a system of internal control over financial reporting to provide reasonable assurance as to the reliability of financial information. The Corporation has an internal audit department whose functions include reviewing internal controls and their application, on an ongoing basis.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control over financial reporting and exercises this responsibility through the Audit, Finance and Risk Committee of the Board, which is composed of directors who are not employees of the Corporation. The Audit, Finance and Risk Committee meets with management, the internal auditors and the external auditors at least four times each year.

The external auditors, PricewaterhouseCoopers conduct an independent audit, in accordance with generally accepted auditing standards and express their opinion on the financial statements. An audit is planned and performed to obtain reasonable assurance whether the financial statements are free of material misstatement. The external auditors have full and free access to the Audit, Finance and Risk Committee of the Board and meet with it on a regular basis.

Brian Dunne
Executive Vice President and
Chief Financial Officer

Robert A. Milton
Chairman, President and
Chief Executive Officer, ACE

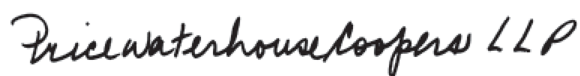
AUDITORS' REPORT

To the Shareholders of ACE Aviation Holdings Inc.

We have audited the consolidated statements of financial position of ACE Aviation Holdings Inc. (the "Corporation") as at December 31, 2005 and 2004 and the consolidated statements of operations and retained earnings and cash flows for the year ended December 31, 2005 and the period from June 29, 2004, date of incorporation, to December 31, 2004. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

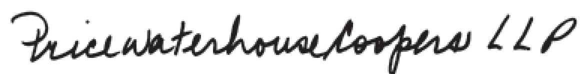
In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2005 and 2004 and the results of its operations and the changes in its cash flows for the year ended December 31, 2005 and the period from June 29, 2004 to December 31, 2004 in accordance with Canadian generally accepted accounting principles.



Chartered Accountants
Montréal, Québec
February 9, 2006

Comments by Auditors on Canadian/United States Reporting Differences

In the United States, reporting standards for auditors require the addition of an explanatory paragraph when there is a change in accounting principles that has a material effect on the comparability of the Corporation's financial statements, such as the changes described in Note 2 and 23 to the financial statements. In addition, the auditors' report would emphasize in a separate paragraph certain matters regarding the financial statements such as those described in Notes 2 and 20 to the consolidated financial statements. Accordingly, it should be noted that the Ontario Superior Court of Justice confirmed the consolidated plan of reorganization, compromise and arrangement (the "Plan") of Air Canada and certain of its subsidiaries (the "Applicants" and "Predecessor") on August 23, 2004. Confirmation of the Plan resulted in a settlement of all claims against the Applicants that arose before April 1, 2003 and substantially altered the rights and interests of equity security holders of Air Canada as provided for in the Plan. The Plan was substantially consummated on September 30, 2004 and the Predecessor emerged from creditor protection. In connection with the Predecessor's emergence from creditor protection, creditors and shareholders received shares of ACE Aviation Holdings Inc., a newly-formed holding company. As a result, consolidated financial statements of ACE Aviation Holdings Inc. reflect a fresh start basis of accounting as of September 30, 2004 as described in Note 20 to the consolidated financial statements. Our report to the shareholders dated February 9, 2006 is expressed in accordance with Canadian reporting standards which do not require a reference to such changes in accounting principles or events in the auditors' report when these are adequately disclosed in the financial statements.



Chartered Accountants
Montréal, Québec
February 9, 2006

AUDITORS' REPORT (cont'd)

To the Shareholder of Air Canada

We have audited the consolidated statements of operations and retained earnings and cash flows of **Air Canada** (the "Predecessor") for the nine-month period ended September 30, 2004. These consolidated financial statements are the responsibility of the Predecessor's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the results of the Predecessor's operations and the changes in its cash flows for the nine-month period ended September 30, 2004 in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Montréal, Québec
February 9, 2006

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

	Successor Company - ACE (note 2)		Predecessor Company Air Canada (note 2)
(in millions except per share figures - Canadian dollars)	Year Ended Dec 31, 2005	Period Ended Dec 31, 2004	Nine Months Ended Sept 30, 2004
Operating Revenues			
Passenger	$ 8,269	$ 1,681	$ 5,628
Cargo	620	151	405
Other	941	230	805
	9,830	2,062	6,838
Operating expenses			
Salaries, wages and benefits	2,520	596	1,989
Aircraft fuel	2,198	432	1,174
Aircraft rent (note 2 dd)	417	111	521
Airport and navigation fees	924	198	616
Aircraft maintenance, materials and supplies	367	78	265
Communications and information technology	303	66	236
Food, beverages and supplies	334	76	264
Depreciation, amortization and obsolescence (note 2 dd)	482	85	312
Commissions	253	65	240
Other	1,580	358	1,101
	9,378	2,065	6,718
Operating income (loss) before reorganization and restructuring items	452	(3)	120
Reorganization and restructuring items (note 21)	-	-	(871)
Non-operating income (expense)			
Dilution gain (note 13)	190	-	-
Interest income	66	11	6
Interest expense	(315)	(60)	(169)
Interest capitalized	14	2	-
Loss on sale of and provisions on assets	(28)	-	(75)
Other	(12)	-	(8)
	(85)	(47)	(246)
Income (loss) before the following items	367	(50)	(997)
Non-controlling interest (note 2)	(24)	-	-
Foreign exchange gain	46	78	104
Provision for income taxes (note 8)	(131)	(13)	(2)
Income (loss) for the period	$ 258	$ 15	$ (895)
Plan of arrangement and fresh start reporting (note 20)	-	-	6,042
Retained earnings (deficit), beginning of period as originally reported	15	-	(5,147)
Adjustment related to a change in accounting policy (note 2 dd)	142	-	-
Retained earnings (deficit), beginning of period as restated	157	-	(5,147)
Retained earnings, end of period	$ 415	$ 15	$ -
Earnings (loss) per share (note 14)			
- Basic	$ 2.63	$ 0.17	$ (7.45)
- Diluted	$ 2.46	$ 0.17	$ (7.45)

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

ACE Aviation Holdings Inc.
Consolidated Statement of Financial Position

(in millions of Canadian dollars)	December 31, 2005	December 31, 2004
ASSETS		
Current		
Cash and cash equivalents (note 13)	$ 1,565	$ 1,481
Short-term investments (note 2 r)	616	151
	2,181	1,632
Restricted cash	86	118
Accounts receivable	637	547
Spare parts, materials and supplies	325	237
Prepaid expenses and other current assets	125	161
	3,354	2,695
Property and equipment (note 3)	5,494	3,684
Deferred charges (note 4)	145	167
Intangible assets (note 5)	2,462	2,703
Investments and other assets (note 6)	392	137
	$ 11,847	$ 9,386
LIABILITIES		
Current		
Accounts payable and accrued liabilities	$ 1,355	$ 1,197
Advance ticket sales	711	579
Aeroplan deferred revenues	680	622
Current portion of long-term debt and capital lease obligations (note 7)	265	218
	3,011	2,616
Long-term debt and capital lease obligations (note 7)	3,543	2,328
Convertible preferred shares (note 12)	148	132
Future income taxes (note 8)	221	243
Pension and other benefit liabilities (note 9)	2,154	2,344
Non-controlling interest	203	-
Other long-term liabilities (note 10)	1,399	1,520
	10,679	9,183
Commitments (note 16) **Contingencies and Guarantees** (note 18)		
SHAREHOLDERS' EQUITY		
Share capital and other equity (note 12)	747	187
Contributed surplus	6	1
Retained earnings	415	15
	1,168	203
	$ 11,847	$ 9,386

On behalf of the Board of Directors:

Robert A. Milton
Chairman, President and Chief Executive Officer

David I. Richardson
Chairman of the Audit, Finance and Risk Committee

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

ACE Aviation Holdings Inc.
Consolidated Statement of Cash Flow and Retained Earnings

(in millions of Canadian dollars) Cash flows from (used for)	Successor Company - ACE (note 2) Year Ended Dec 31, 2005	Successor Company - ACE (note 2) Period Ended Dec 31, 2004	Predecessor Company Air Canada (note 2) Nine Months Ended Sept 30, 2004
Operating			
Income (loss) for the period	$ 258	$ 15	$ (895)
Adjustments to reconcile to net cash provided by operations			
Reorganization and restructuring items (note 21)	-	-	786
Depreciation, amortization and obsolescence	482	85	312
Loss on sale of and provisions on assets	28	-	75
Dilution gain (note 13)	(190)	-	-
Foreign exchange	(83)	(98)	(104)
Future income taxes	116	11	(5)
Employee future benefit funding (more than) less than expense	(74)	(52)	126
Decrease (increase) in accounts receivable	(43)	269	(191)
Decrease (increase) in spare parts, materials and supplies	(92)	(30)	-
Increase (decrease) in accounts payable and accrued liabilities	45	(256)	34
Increase (decrease) in advance ticket sales, net of restricted cash	132	(77)	196
Aircraft lease payments (in excess of) less than rent expense	33	(14)	(31)
Other	63	35	57
Cash flows from (used for) operating activities before under noted items	675	(112)	360
Settlement of lease obligations (note 19)	-	(290)	-
Rebate on lease settlement	-	33	-
Payment of restructuring obligation (note 19)	-	(45)	-
Fees conditional on emergence	-	(12)	-
	675	**(426)**	**360**
Financing			
Issue of share capital (note 12)	452	1	-
Issue of convertible notes (note 7)	319	-	-
Issue of subsidiary units (note 13)	232	-	-
Aircraft related borrowings (note 7)	404	-	233
Credit facility borrowings (note 7)	300	-	80
Reduction of long-term debt and capital lease obligations	(894)	(67)	(358)
Preferred shares issued to Cerberus for cash	-	238	-
Shares issued for cash under Rights Offering	-	852	-
GE DIP financing	-	(300)	300
Drawdown of Exit Financing	-	527	-
Distributions paid to non-controlling interest	(8)	-	-
Other	(4)	-	(2)
	801	**1,251**	**253**
Investing			
Short-term investments	(465)	(151)	186
Sale of subsidiary units (note 13)	35	-	-
Additions to capital assets	(882)	(129)	(328)
Proceeds from sale of assets	42	-	2
Cash collaterization of letters of credit	(35)	(21)	-
Investment in US Airways (note 6)	(87)	-	-
	(1,392)	**(301)**	**(140)**
Increase in cash and cash equivalents	84	524	473
Cash and cash equivalents, beginning of period	1,481	-	484
Cash and cash equivalents transferred to the Successor Company	-	957	(957)
Cash and cash equivalents, end of period	**$ 1,565**	**$ 1,481**	**$ -**

Cash and cash equivalents exclude short-term investments of $616 as at December 31, 2005 ($151 as at December 31, 2004)

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

1. NATURE OF OPERATIONS

ACE Aviation Holdings Inc. ("ACE") incorporated on June 29, 2004, is the parent holding company of various transportation and other service companies and partnerships.

Reference to "Corporation" in the following notes to the consolidated financial statements 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.

The Corporation's businesses on a consolidated basis are operated through four reporting segments which include:

TRANSPORTATION SERVICES

Transportation services includes the Corporation's principal passenger and cargo transportation services operated by Air Canada and related ancillary services.

These services are provided through the Corporation's 100% ownership interest in Air Canada, AC Cargo Limited Partnership ("Air Canada Cargo"), ACGHS Limited Partnership ("ACGHS"), and Touram Limited Partnership ("Air Canada Vacations"). Effective September 30, 2004, the Transportation Services segment is responsible for sales of transportation services provided by Jazz Air LP ("Jazz" or "Jazz LP") operated aircraft. The Transportation Services segment includes the transportation revenues related to Jazz operated aircraft and rental income from aircraft leased to Jazz by subsidiaries of Air Canada and the costs related to fees paid to Jazz, as provided for under a capacity purchase agreement.

Air Canada is Canada's largest domestic and international full-service airline and the largest provider of scheduled passenger services in the domestic market, the US transborder market as well as Canada-International markets. Through Air Canada's global route network, virtually every major market throughout the world is served either directly or through the Star Alliance network. Air Canada is a founding member of the Star Alliance network which is the world's largest airline alliance group.

Air Canada and Air Canada Cargo provide air cargo services on domestic, transborder and international flights. Air Canada Cargo is a major domestic air cargo carrier and uses the entire cargo capacity on aircraft operated by Air Canada and Jazz on domestic and transborder routes. Air Canada offers cargo services on its international flights.

ACGHS provides passenger handling services to Air Canada, Jazz and other airlines with a primary focus on Canadian stations. Services covered include "above and below the wing" passenger and baggage handling services and ancillary services such as de-icing, ground support, and equipment maintenance.

Air Canada Vacations is a major Canadian tour operator providing vacation packages which include air transportation supplied by Air Canada, hotel accommodations, car rentals and cruises.

AEROPLAN LIMITED PARTNERSHIP

The Corporation holds an 85.6% ownership in Aeroplan Limited Partnership ("Aeroplan" or "Aeroplan LP"). Aeroplan is a premier loyalty program which offers miles accumulation and redemption as an incentive to the Corporation's and other partners' customers. Accumulated mileage may be redeemed for travel rewards or for goods and services from non-airline partners.

JAZZ AIR LP

The Corporation holds a 100% ownership in Jazz as at December 31, 2005 (see note 24 Subsequent Events). Jazz is responsible for regional operations and provides service throughout Canada and to certain destinations in the United States under a capacity purchase agreement between Air Canada and Jazz that came into effect September 30, 2004. Under the capacity purchase agreement, Jazz focuses on flight operations and customer service and Air Canada is responsible for scheduling, marketing, pricing and related commercial activities of the regional operations. Under this agreement, Jazz records revenues from Air Canada based upon fees relating to flight operations performed, passengers carried and other items covered by the agreement.
These inter-company transactions are eliminated in the consolidated financial statements.

ACTS LIMITED PARTNERSHIP

The Corporation holds a 100% ownership in ACTS Limited Partnership ("ACTS" or "ACTS LP"). ACTS provides technical services and competes on a global basis as an aircraft maintenance, repair and overhaul service provider.

Financial information on ACE operating segments is outlined in note 15, Segment Information.

OTHER

In addition to the above segments, ACE holds a 6% investment in US Airways Group Inc. (see note 6).

REORGANIZATION OF AIR CANADA

On September 30, 2004, Air Canada, and certain subsidiaries, emerged from creditor protection under the provisions of the Companies' Creditors Arrangement Act (Canada) ("CCAA") as explained in notes 19 to 22.

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements are expressed in millions of Canadian dollars and are prepared in accordance with generally accepted accounting principles ("GAAP") in Canada. The accounting policies of ACE are consistent with those of Air Canada and its subsidiaries prior to September 30, 2004 ("Predecessor Company"), with the exception of the fair value adjustments applied under fresh start reporting and certain accounting policies as outlined below.

A) BASIS OF PRESENTATION

In accordance with Section 1625 of the CICA Handbook, Comprehensive Revaluation of Assets and Liabilities ("CICA 1625"), ACE adopted fresh start reporting on September 30, 2004. References to "Predecessor Company" in these consolidated financial statements and notes thereto refer to Air Canada and its subsidiaries prior to September 30, 2004. References to "Successor Company" refer to ACE and its subsidiaries on and after June 29, 2004. In accordance with CICA 1625, prior period financial information has not been restated to reflect the impact of the fair value adjustments, and accordingly certain amounts in the Predecessor Company's results are not directly comparable with those of the Corporation. See note 20 for information related to fresh start reporting.

The consolidated statement of financial position as of December 31, 2005 and December 31, 2004 represents the accounts of the Corporation. The consolidated statement of operations for the year ended December 31, 2005, and the period from incorporation of ACE to December 31, 2004 reflects the operations of the Corporation; the nine months ended September 30, 2004 reflect the results of operations of the Predecessor Company. The consolidated statement of cash flow for the year ended December 31, 2005, and the period from incorporation of ACE to December 31, 2004 reflects the cash flows of the Corporation. The nine months ended September 30, 2004 reflect the cash flows of the Predecessor Company.

For the nine months ended September 30, 2004, while Air Canada and certain of its subsidiaries operated under CCAA proceedings, the Predecessor Company followed accounting policies, including disclosures, applicable to entities under creditor protection. In addition to generally accepted accounting principles applicable in Canada, the Predecessor Company applied the guidance in American Institute of Certified Public Accountant Statement of Position 90-7, "Financial Reporting by Entities in Reorganization under the Bankruptcy Code" (SoP 90-7). Accordingly, revenues, expenses (including professional fees), realized gains and losses and provisions for losses directly associated with the reorganization and restructuring of the business were reported separately as reorganization items.

For the nine months ended September 30, 2004, interest expense on compromised liabilities was reported only to the extent that it would be paid under the Plan or that it was probable that it would be an allowed claim. Cash flows related to reorganization items have been disclosed separately in the consolidated statement of cash flows. Consolidated financial statements that include one or more entities in reorganization proceedings and one or more entities not in reorganization proceedings include disclosure of condensed combined financial statements of the entities in reorganization proceedings, including disclosure of the amount of intercompany receivables and payables therein between Applicants and non-Applicants. This information is presented in note 22.

B) BASIS OF VALUATION

With the application of fresh start reporting on September 30, 2004 by the Corporation, all assets and liabilities, except for future income taxes, were reported at fair values as further described in note 20. Goodwill is not recorded under GAAP applicable to fresh start reporting. In addition, the estimated useful lives of certain assets were also adjusted, including buildings where useful lives were extended to periods not exceeding 50 years.

C) PRINCIPLES OF CONSOLIDATION

These consolidated financial statements include the accounts of the Predecessor Company and its subsidiaries and the Corporation and its subsidiaries with provision for non-controlling interests. For the periods beginning January 1, 2005, the consolidated financial statements of the Corporation include the accounts of entities for which the Corporation is the primary beneficiary. All intercompany balances and transactions are eliminated.

D) USE OF ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

E) AIR TRANSPORTATION REVENUES

Airline passenger and cargo advance sales are deferred and included in current liabilities. Passenger and cargo revenues are recognized when the transportation is provided, except for revenue on unlimited flight passes which is recognized on a straight-line basis over the period during which the travel pass is valid. The Corporation has formed alliances with other airlines encompassing loyalty program participation, code sharing and coordination of services including reservations, baggage handling and flight schedules. Revenues are allocated based upon formulas specified in the agreements and are recognized as transportation is provided. As described further under Aeroplan Loyalty Program, beginning September 30, 2004, the estimated fair value of Aeroplan Miles earned through qualifying air travel is deferred at the time the qualifying air travel is provided. Deferred revenues from the issue of Miles ("Miles") to customers, including Miles sold to loyalty program partners are recorded as passenger revenues when the transportation is provided. Redemptions for non-passenger services are included in other revenues.

The Corporation performs regular evaluations on the deferred revenue liability which may result in adjustments being recognized as revenue. Due to the complex pricing structures; the complex nature of interline and other commercial agreements used throughout the industry; historical experience over a period of many years; and other factors including refunds, exchanges and unused tickets, certain relatively small amounts are recognized as revenue based on estimates. Events and circumstances may result in actual results that are different from estimates, however these differences have historically not been material.

F) CAPACITY PURCHASE AGREEMENTS

The Corporation has capacity purchase agreements with certain unaffiliated regional carriers, which are referred to as Tier III carriers, operating aircraft of 18 seats or less. Under these agreements, the Corporation is responsible for the marketing, ticketing and commercial arrangements relating to these flights and records the earned revenues in passenger revenue. For the year ended December 31, 2005, passenger revenues under capacity purchase agreements with Tier III carriers amounted to $70 in the Corporation. During the three months ended December 31, 2004, passenger revenues under capacity purchase agreements with Tier III carriers amounted to $16 in the Corporation and $46 in the Predecessor Company for the nine months ended September 30, 2004. Operating expenses are recorded primarily in the aircraft fuel, airport and navigation fees and other operating expense categories.

G) AEROPLAN LOYALTY PROGRAM

As a result of the application of fresh start reporting, the outstanding loyalty program mileage credits 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 Corporation 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.

Revenues from Miles issued to members are recognized at the time the Miles are redeemed except for breakage as noted below. Effective September 30, 2004, Miles redeemed for travel on Air Canada and Jazz are included in Passenger revenue and Miles redeemed for other than travel are included in Other revenues. Under the previous accounting policy in the Predecessor Company, Aeroplan redemption revenues from Miles earned by members through loyalty program partners were included in Other revenues. These revenues amounted to $173 for the nine months ended September 30, 2004.

Based on historical experience and current program policies the Corporation estimates the percentage of Miles that may never be redeemed, defined as breakage. Breakage is estimated by the Corporation based on the terms and conditions of membership and historical accumulation and redemption patterns as adjusted for changes to any terms and conditions that affect members' redemption practices. The estimated breakage factor used is 17% since September 2004 and 19% prior to September 2004. The cumulative adjustment resulting from this change in estimate was recognized in 2004 as a reduction in revenue amounting to $18, including $9 related to prior periods and $9 related to 2004. Changes in the breakage factor are accounted for as follows: in the period of change, the deferred revenue balance is adjusted as if the revised estimate had been used in prior periods with the offsetting amount recorded as an adjustment to Other revenues; and for subsequent periods, the revised estimate is used. The amount allocated to breakage is recognized in Other revenues on a straight line basis over a period of 30 months, which is the estimated average life of a Mile.

The current portion of Aeroplan loyalty program deferred revenues of $680 ($622 at December 31, 2004) is based on Management's estimate as to the portion of the liabilities that will be redeemed in the next twelve months. The remainder of the liabilities is carried in Other long-term liabilities.

H) NON-TRANSPORTATION REVENUES

Non-transportation revenue includes certain loyalty program revenues, as described above, 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.

Revenues relating to airframe maintenance services are recognized as the services are performed. Revenues and costs relating to engine and component maintenance services are deferred and only recognized once the work has been completed.

Certain maintenance contracts are referred to as power by the hour whereby the customer makes payments based on their aircraft utilization. Customer receipts under a power by the hour contract are deferred in current liabilities and recognized as revenues as maintenance services are performed.

Other airline related service revenues are recognized as services are provided.

I) EMPLOYEE FUTURE BENEFITS

The significant policies related to employee future benefits are as follows:

- The cost of pensions and other post-retirement benefits earned by employees is actuarially determined using the projected benefit method prorated on service, market interest rates, and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.

- A market-related value method is used to value plan assets for the purpose of calculating the expected return on plan assets. Under the selected method, the differences between investment returns during a given year and the expected investment returns are amortized on a straight line basis over 4 years.

- Past service costs arising from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. This period does not exceed the average remaining service period of such employees up to the full eligibility date.

- Cumulative unrecognized net actuarial gains and losses in excess of 10% of the greater of the projected benefit obligation or market-related value of plan assets at the beginning of the year are amortized over the remaining service period of active employees.

J) STOCK-BASED COMPENSATION PLANS

The Corporation has a stock option plan as described in note 11. The fair value of stock options granted is recognized as a charge to salary and wages expense on a straight line basis over the applicable vesting period, with an offset to contributed surplus. The amount of compensation cost recognized at any date at least equals the value of the vested portion of the options at that date. When stock options are exercised, the consideration paid by employees, together with the amount in contributed surplus, is credited to share capital.

The Corporation also maintains an employee share purchase plan under which employee contributions are matched by a plan specific percentage by the Corporation.

K) EMPLOYEE PROFIT SHARING PLAN

The Corporation has implemented an employee profit sharing plan which is calculated annually on full calendar year results and recorded throughout the year as a charge to salary and wage expense based on the estimated annual payment under the plan.

L) MAINTENANCE AND REPAIRS

Maintenance and repair costs are charged to operating expenses as incurred, with the exception of maintenance and repair costs related to return conditions on short-term aircraft leases, which are accrued over the term of the lease.

M) OTHER OPERATING EXPENSES

Included in other operating expenses are expenses related to building rent and maintenance, terminal handling, professional fees and services, crew meals and hotels, advertising and promotion, insurance costs, credit card fees, Aeroplan Miles redeemed for other than travel, and other expenses. Expenses are recognized as incurred.

N) FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

Under the Corporation's risk management policy, derivative financial instruments are used only for risk management purposes, not for generating trading profits. When the Corporation utilizes derivatives in hedge accounting relationships, the Corporation identifies, designates and documents those transactions and regularly tests the transactions to demonstrate effectiveness in order to continue hedge accounting. To the extent that a derivative financial instrument does not qualify for hedge accounting or for those that are not designated as hedges, the fair value of the derivative financial instrument is recorded on the consolidated statement of financial position and changes in its fair value are recorded in income in the period when the change occurs.

Changes in the fair value of foreign currency forward contracts and option agreements, used for foreign exchange risk management but not designated as hedges for accounting purposes, are recorded in foreign exchange gain (loss). These contracts are included on the consolidated statement of financial position at fair value in Other assets and Other long-term liabilities.

Changes in the fair value of currency swap agreements, used for foreign exchange risk management and not designated as hedges for accounting purposes, are recorded in foreign exchange gain (loss). These contracts are included on the consolidated statement of financial position at fair value in Other assets and Other long-term liabilities.

The Corporation from time to time enters into interest rate swaps to manage the risks associated with interest rate movement on US and Canadian floating rate debt and investments. Changes in the fair value of these swap agreements, which are not designated as hedges for accounting purposes, are recognized in income in Other non-operating income and are recorded on the statement of financial position in Other assets and Other long-term liabilities.

Derivatives under the fuel-hedging program are designated as hedges for accounting purposes and hedge accounting is being applied prospectively from October 1, 2005. Under hedge accounting, gains or losses on fuel hedging contracts are recognized in earnings as a component of aircraft fuel expense when the underlying jet fuel being hedged is consumed. Premiums paid for option contracts and the excluded time value of the options is deferred as a cost of the hedge on the balance sheet in Other assets and recognized in the income statement at the same time as the hedged jet fuel is consumed. Similarly, the value of the derivatives previously measured at fair value where the Corporation did not apply hedge accounting is also treated as a cost of the hedge and accounted for in the same way. The intrinsic value of the options and any new derivatives contracts fair values excluding time value are treated as an off-balance sheet item. Prior to these derivative instruments being designated as hedges for accounting purposes, gains or losses were recorded in other non-operating expense.

The Corporation will discontinue hedge accounting when the hedge item matures, expires, is sold, terminated, cancelled or exercised, the Corporation terminates its designation of the hedging relationship, the hedging relationship ceases to be effective, or the anticipated transaction is no longer probable.

When a hedging item ceases to exist and is not replaced, any gain, losses, revenue or expenses associated with the hedging item that have been deferred previously as a result of applying hedge accounting are carried forward to be recognized in income in the same period as the corresponding gains, losses, revenues or expenses associated with the hedged item.

When a hedged item ceases to exist or an anticipated transaction is no longer probable, any gains, losses, revenues or expenses associated with the hedging item that had been deferred previously as a result of hedge accounting are realized in the current period's statement of operations.

O) FOREIGN CURRENCY TRANSLATION

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange in effect at the date of the consolidated statement of financial position. Net gains of $46 are included in income in the Corporation for the twelve months ended December 31, 2005. Net gains of $78 are included in income in the Corporation for the period ended December 31, 2004. Gains of $190 are included in income in the Predecessor Company for the nine months ended September 30, 2004, of which $84 is included in Reorganization and restructuring items. Non-monetary assets, non-monetary liabilities, revenues and expenses arising from transactions denominated in foreign currencies, are translated at rates of exchange in effect at the date of the transaction.

P) INCOME TAXES

The Corporation utilizes the liability method of accounting for income taxes under which future income tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amount and the tax basis of assets and liabilities. Future income tax assets and liabilities are measured using substantively enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment date. Future income tax assets are recognized to the extent that realization is considered more likely than not. The benefit of future income tax assets that existed at fresh start, and for which a valuation allowance is recorded, will be recognized first to reduce to nil any remaining intangible assets (on a pro-rata basis) that were recorded upon fresh start reporting with any remaining amount as a credit to shareholders' equity. The benefit of future income tax assets that arise after fresh start will be recognized in the income statement.

Q) CASH AND CASH EQUIVALENTS

Cash includes investments with original maturities of three months or less of $1,540 (2004 $1,406). Investments, comprised of bankers acceptances, bankers discount notes, and commercial paper may be liquidated promptly and have maturities of three months or less at the date of purchase. The weighted average interest rate on investments as at December 31, 2005 is 3.31% (2004 2.6%).

R) SHORT-TERM INVESTMENTS

Short-term investments, comprised of bankers acceptances and bankers discount notes, have original maturities over three months, but not more than one year. The weighted average interest rate on short-term investments as at December 31, 2005 is 3.04% (2004 2.6%)

S) RESTRICTED CASH

As at December 31, 2005, the Corporation has recorded $86 (2004 $118) in restricted cash, under current assets, representing funds held in trust by Air Canada Vacations in accordance with regulatory requirements governing advance ticket sales, recorded under current liabilities, for certain travel related activities.

T) SPARE PARTS, MATERIALS AND SUPPLIES

Spare parts, materials and supplies are valued at the lower of average cost and net realizable value. A provision for the obsolescence of flight equipment spare parts is accumulated over the estimated service lives of the related flight equipment to a 30% residual value.

U) PROPERTY AND EQUIPMENT

Property and equipment is originally recorded at cost. Property under capital leases and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of fair value of the property or equipment and the present value of those lease payments. On September 30, 2004, the estimated useful lives of certain assets were adjusted, including buildings where useful lives were extended to periods not exceeding 50 years.

Property and equipment are depreciated to estimated residual values based on the straight-line method over their estimated service lives. Property and equipment under capital leases and variable interest entities are depreciated to estimated residual values over the life of the lease. Air Canada aircraft and flight equipment are depreciated over 20 to 25 years, with 10 to 15% estimated residual values. Jazz aircraft and flight equipment are depreciated over 20 to 30 years, with 20% estimated residual values. Aircraft reconfiguration costs are amortized over 3 years. Betterments to owned aircraft are capitalized and amortized over the remaining service life of the aircraft. Betterments to aircraft on operating leases are amortized over the term of the lease.

Buildings are depreciated over their useful lives not exceeding 50 years on a straight line basis (30 years in the Predecessor Company). An exception to this is where the useful life of the building is greater than the term of the land lease. In these circumstances, the building is depreciated over the life of the lease. Leasehold improvements are amortized over the lesser of the lease term or 5 years. Ground equipment is depreciated over 3 to 25 years (5 to 25 years in the Predecessor Company). Computer equipment is depreciated over 3 years (5 years in the Predecessor Company).

V) INTEREST CAPITALIZED

Interest on funds used to finance the acquisition of new flight equipment and other property and equipment is capitalized for periods preceding the dates that the assets are available for service.

W) DEFERRED FINANCING COSTS

Deferred financing costs are amortized on an effective interest basis over the term of the related obligation.

X) INTANGIBLE ASSETS

As a result of the application of fresh start reporting, intangible assets were recorded at their estimated fair values at September 30, 2004. Indefinite life assets are not amortized while assets with finite lives are amortized to nil over their estimated useful lives.

	Estimated Useful Life
International route rights and slots	Indefinite
Air Canada trade name	Indefinite
Aeroplan trade name	Indefinite
Other marketing based trade names	Indefinite
Aeroplan contracts	25 years
Star Alliance membership	25 years
Other contract and customer based intangible assets	10 to 15 years
Technology based intangible assets	1 to 25 years

Y) IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets are tested for impairment whenever the circumstances indicate that the carrying value may not be recoverable. When events or circumstances indicate that the carrying amount of long-lived assets are not recoverable, the long-lived assets are tested for impairment by comparing the estimate of future expected cash flows to the carrying amount of the assets or groups of assets. If the carrying value is not recoverable from future expected cash flows, any loss is measured as the amount by which the asset's carrying value exceeds fair value. Recoverability is assessed relative to undiscounted cash flows from the direct use and disposition of the asset or group of assets.

Indefinite-lived intangible assets are also subject to annual impairment tests under GAAP. If the carrying value of such assets exceeds the fair values, the assets are written down to fair value.

Z) 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.

AA) AIRCRAFT LEASE PAYMENTS IN EXCESS OF OR LESS THAN RENT EXPENSE

Total aircraft operating lease rentals over the lease term are amortized to operating expense on a straight-line basis. Included in deferred charges and long-term liabilities is the difference between the straight line aircraft rent expense and the payments as stipulated under the lease agreement. On fresh start accounting, an intangible asset related to leases, included in deferred charges, was recognized based on the fair value of shares issued to lessors as a result of the claim on renegotiated lease agreements and the allocation of lease damages paid to GE as described in Note 19.

When there is an expected deficiency under a residual value guarantee in an aircraft operating lease, the Corporation accrues the deficiency over the remaining lease term. Any accruals for residual value guarantees are included in other long-term liabilities. As a result of the adoption of AcG-15 as described below, the Corporation no longer has any residual value guarantees under any of its aircraft leasing agreements accounted for as operating leases.

BB) ASSET RETIREMENT OBLIGATIONS

The Corporation records 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. 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.

CC) COMPARATIVE FIGURES

Certain prior period's information was reclassified to conform with the current year's presentation.

DD) CHANGE IN ACCOUNTING POLICIES

The Corporation adopted Accounting Guideline 15 – Consolidation of Variable Interest Entities (AcG-15) 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.

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

Aircraft and Engine Leasing Transactions

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

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

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

Fuel Facilities Arrangements

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

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

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

The remaining five Fuel Facilities Corporations in Canada that have not been consolidated have assets of approximately $107 and debt of approximately $87, which is the Corporation's maximum exposure to loss without taking into consideration any cost sharing and asset retirement obligations that would occur amongst the other contracting airlines. The Corporation views this loss potential as remote.

Effect in the Current Period

For the year ended December 31, 2005, the net impact of adopting AcG-15 was a before tax charge of $42 ($0.43 per share, basic). This impact is a result of depreciation expense of $86, net interest expense of $88, foreign exchange gain of $26 and non-controlling interest charge of $14 offset by reduced aircraft rent of $120.

Prior Periods

The comparative financial information for prior periods has not been restated. The cumulative effect to retained earnings on the adoption of AcG-15 as at January 1, 2005 is an increase of $142.

EE) FUTURE ACCOUNTING STANDARD CHANGES

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

Financial Instruments and Hedges

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 that 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 unrealized gains and losses – other comprehensive income – has been introduced. This provides an ability for certain unrealized 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. The standards do not permit restatement of prior years' financial statements, however, the standards have detailed transition provisions. As the Corporation has financial instruments, implementation planning will be necessary to review the new standards to determine the consequences for the Corporation. Accordingly, the Corporation has not yet evaluated all of the consequences of the new standards; however, the adoption of the standards may have a material impact on the Corporation's balance sheet.

3. PROPERTY AND EQUIPMENT

	2005	2004
Cost		
Flight equipment	$ 1,703	$ 1,179
Flight equipment consolidated under AcG-15	1,304	-
Capital leases [(a)]	1,758	1,758
Buildings and leasehold improvements	534	520
Fuel facilities consolidated under AcG-15	115	-
Ground equipment and other	161	164
Computer equipment	4	1
	5,579	3,622
Accumulated depreciation and amortization		
Flight equipment	104	18
Flight equipment consolidated under AcG-15	80	-
Capital leases [(a)]	142	22
Buildings and leasehold improvements	48	10
Fuel facilities consolidated under AcG-15	6	-
Ground equipment and other	26	5
Computer equipment	3	-
	409	55
	5,170	3,567
Purchase deposits [(b)]	324	117
Property and equipment at net book value	$ 5,494	$ 3,684

(a) Included in capital leases are 35 aircraft (2004 - 35) with a cost of $1,684 (2004 - $1,684) less accumulated depreciation of $130 (2004 - $20) for a net book value of $1,554 (2004 - $1,664), computer equipment with a cost of $28 (2004 - $28) less accumulated depreciation of $9 (2004 - $2) for a net book value of $19 (2004 - $26) and facilities with a cost of $46 (2004 - $46) less accumulated depreciation of $3 (2004 - nil) for a net book value of $43 (2004 - $46).

(b) Includes $189 for Boeing B777/787 aircraft, $65 for Embraer aircraft and $70 for equipment purchases and internal projects.

Interest capitalized for the year ended December 31, 2005 amounted to $14 using the Corporation's weighted average cost of capital. Interest capitalized for the period ended December 31, 2004 amounted to $2. No interest was capitalized during the nine months ended September 30, 2004 by the Predecessor Company.

During the year ended December 31, 2005, the Corporation recorded depreciation expense of $374. During the period ended December 31, 2004, the Corporation recorded depreciation expense of $65 and during the nine months ended September 30, 2004, the Predecessor Company recorded depreciation expense of $259.

During the year ended December 31, 2005, the Corporation recorded provisions of $17, including $13 for spare parts. During the nine months ended September 30, 2004, the Predecessor Company recorded provisions of $75 relating mainly to non-operating aircraft, including $18 for spare parts. The provisions reflect the excess of the carrying value over fair value.

As at December 31, 2005, flight equipment included 32 aircraft (2004 - 57) which are retired from active service with a net book value of $10 (2004 - $6) which approximates fair value.

4. DEFERRED CHARGES

	2005	2004
Aircraft lease payments in excess of rent expense [(a)]	$ 106	$ 141
Financing costs	39	26
	$ 145	$ 167

a) The deferred charge related to aircraft lease payments in excess of rent expense includes the fair value of shares issued to lessors as a result of the claim on renegotiated lease agreements and the allocation of lease damages paid to GECC as further described in note 19, less the net amortization recorded. This deferred charge is amortized to Aircraft rent over the term of the lease agreements.

5. INTANGIBLE ASSETS

	2005	2004
Indefinite life assets		
International route rights and slots	$ 653	$ 688
Air Canada trade name	595	628
Aeroplan trade name	109	135
Other marketing based trade names	118	131
	1,475	1,582
Finite life assets		
Aeroplan contracts	407	499
Star Alliance membership	239	246
Other contract and customer based	247	260
Technology based	206	133
	1,099	1,138
Accumulated amortization		
Aeroplan contracts	(23)	(3)
Star Alliance membership	(12)	(1)
Other contract and customer based	(40)	(7)
Technology based	(37)	(6)
	987	1,121
	$ 2,462	$ 2,703

As a result of recognizing the benefit during the year ended December 31, 2005 of future income tax assets that existed at fresh start, and for which a valuation allowance was recorded, intangible assets were reduced on a pro-rata basis by $138 ($11 for the period ended December 31, 2004). As a result of the dilution gain as described in note 13, intangible assets related to Aeroplan were reduced by $77.

For the year ended December 31, 2005, the Corporation recorded amortization expense of $95. During the period ended December 31, 2004, the Corporation recorded amortization expense of $17 and during the nine months ended September 30, 2004, the Predecessor Company recorded amortization expense of $39.

6. INVESTMENTS AND OTHER ASSETS

	2005	2004
Investment in US Airways Group Inc. [a]	$ 87	$ -
Aircraft related deposits and derivatives	167	40
Collateral under letters of credit and other deposits	127	54
Directors' and Officers' Trust [b]	-	32
Other	11	11
	$ 392	$ 137

(a) On September 27, 2005, the Corporation invested $87 (US$75) in US Airways Group Inc. ("US Airways") in conjunction with the carrier's exit from US bankruptcy proceedings. The Corporation's investment represented approximately 7% of the equity of US Airways at the closing date. 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. As at December 31, 2005, the market value of the investment was $217. 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.

(b) The Directors' and Officers' Trust represented restricted funds placed in trust for the use of the Directors and Officers of the Corporation under certain circumstances. The Trust was terminated during the year and the Corporation has repatriated these funds.

7. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS

	Final Maturity	Stated Interest Rate at Dec 31, 2005 (%)	2005	2004
ACE Convertible Senior Notes due 2035 [a]	2035	4.25	$ 247	$ -
ACE - GE Exit Financing [b]	2011	-	-	540
Air Canada - Embraer Aircraft Financing [c]	2017-2020	7.71-7.85	393	-
Air Canada - Conditional sales agreements [d]	2019	7.26	198	216
Air Canada - Lufthansa Cooperation Agreement [e]	2009	6.495	59	76
Air Canada - GE Loan [f]	2015	10.42	51	55
Air Canada Revolving Credit Facility [g]	2007	-	-	-
Air Canada - GE Limited Recourse Loan [h]	2014	-	-	30
Air Canada - Amex Financing [i]	2006	-	-	43
Aeroplan Term Credit Facility [j]	2009	-	300	-
Aeroplan Revolving Term Credit Facility [j]	2008	-	-	-
Other	2009-2010	3.00-12.02	17	16
			1,265	976
Air Canada - Debt consolidated under AcG-15 - Aircraft leases [k]			1,125	-
Air Canada - Debt consolidated under AcG-15 - Fuel Facilities Corporations [l]			53	-
Air Canada - Capital lease obligations [m]			1,365	1,570
			3,808	2,546
Current portion			(265)	(218)
Long-term debt and capital lease obligations			$ 3,543	$ 2,328

Principal repayment requirements as at December 31, 2005 on long-term debt, capital lease obligations, and aircraft, engine and fuel facility debt consolidated as variable interest entities under AcG-15 are as follows:

	2006	2007	2008	2009	2010
Long-term debt	$ 48	$ 50	$ 70	$ 349	$ 35
Debt consolidated under AcG-15	76	119	117	59	118
Capital lease principal obligations	141	174	172	84	82
Total	**$ 265**	**$ 343**	**$ 359**	**$ 492**	**$ 235**

(a) During the second quarter, 2005 ACE issued $330 of Convertible Senior Notes due 2035 ("Convertible Notes") for net proceeds of $319. For accounting purposes, the Convertible Notes are presented as a compound instrument. At the date of issuance, the value ascribed to the holders' conversion option, which is presented as equity, was $94 less allocated fees of $2; the value ascribed to the financial liability was $236. The financial liability was calculated by discounting the stream of future payments of interest and principal at the prevailing rate for a similar liability that does not have an associated conversion feature. The financial liability will increase to the face value of the debt over a five year period to June 1, 2010, the first date on which the holder can require ACE to purchase all or a portion of the Convertible Notes, as described further below, resulting in an effective interest rate of 12% on the financial liability.

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

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

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

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

(c) Air Canada completed loan agreements with third parties in 2005 for Embraer aircraft totalling US$337. The loans, secured by the Embraer aircraft, are to be repaid in quarterly installments and mature between 2017 and 2020. The majority of the borrowings bear interest at a fixed interest rate and the remainder bears interest at a floating interest rate equal to the three month US LIBOR plus 3.25%.

(d) Purchases of two A340-500 aircraft financed through conditional sales agreements for an initial value of US$174. Principal and interest is paid quarterly until maturity in 2019. The purchase price instalments bear interest at a three month LIBOR rate plus 2.9% (7.26% as at December 31, 2005).

(e) US$50 borrowing maturing in 2009, with semi annual repayments, at a fixed interest rate of 4.495% plus an annual 2.0% guarantee fee.

(f) US$43 borrowing maturing in 2015, with quarterly repayments, at a floating interest rate equal to the six month LIBOR rate plus 5.75% pre-payable on any interest payment date after December 23, 2007 secured by certain flight training equipment with a current carrying value of $63.

(g) On April 6, 2005, Air Canada entered into a senior secured syndicated revolving credit facility ("the Credit Facility") in an aggregate amount of up to $300 or the US dollar equivalent. The Credit Facility has a two-year term which can be extended at Air Canada's option for additional one-year periods on each anniversary of closing, subject to prior approval by a majority of the lenders. Included in the aggregate amount is a swing line facility of up to $20 provided for cash management and working capital purposes. Until April 2006, the margin under the credit facility is LIBOR plus 3% or prime plus 2%. After that date, the margin fluctuates based on Air Canada's EBITDAR coverage ratio with rates ranging from LIBOR plus 2.5% to 3.5% or prime plus 1.5% to 2.5%. The amount available to be drawn by Air Canada under the Credit Facility is limited to the lesser of $300 and the amount of a borrowing base determined with reference to certain eligible accounts receivable of Air Canada and certain eligible owned and leased real property of Air Canada. As at December 31, 2005, no amount was drawn under this facility. The Credit Facility is secured principally 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.

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

(i) The Amex Financing required monthly principal and interest payments over the term of the Canadian dollar loan which extended to January 5, 2006 and was extendable in six month intervals by mutual consent. Under the terms of the agreement, cash principal payments under the facility were made as loyalty points were purchased and as amounts were due to Air Canada or Aeroplan under various Amex agreements. The facility was subject to interest at the Bank of Montreal's prime lending rate and was secured by all accounts due to Amex under the agreements and all of the present and future licenses, trademarks and design marks owned by Air Canada and Aeroplan and used by Amex in connection with the agreement. This financing was repaid during the third quarter of 2005.

(j) Aeroplan LP has arranged for senior secured credit facilities in the amount of $475. The credit facilities consist of one $300 (or the U.S. dollar equivalent thereof) term facility (the "Term A Facility"), a $100 (or the U.S. dollar equivalent thereof) acquisition facility (the "Term B Facility") and a $75 (or the U.S. dollar equivalent thereof) revolving term facility (the "Revolving Facility").

The Term A Facility and the Term B Facility mature on June 29, 2009, or earlier at the option of Aeroplan and bears interest at rates ranging from Canadian prime rate and U.S. base rate to Canadian prime rate and U.S. base rate plus 0.75% and the Bankers' Acceptance rate and LIBOR plus 1.0% to 1.75%. At December 31, 2005, borrowings under the Term A Facility were in the form of Bankers' Acceptances with a 91 day term and an effective interest rate of 4.4%. The Term A Facility was drawn on June 29, 2005 in the amount of $300, in order to fund a portion of the $400 Aeroplan Miles Redemption Reserve (refer to note 13), included in cash and cash equivalents and short-term investments. As at December 31, 2005, no amounts were drawn under the Term B Facility.

The Revolving Facility matures on June 29, 2008, or earlier at the option of Aeroplan and bears interest at rates ranging from Canadian prime rate and U.S. base rate to Canadian prime rate and U.S. base rate plus 0.75% and the Bankers' Acceptance rate and LIBOR plus 1.0% to 1.75%. At December 31, 2005, no amounts were drawn under this facility.

The senior secured credit facilities are secured by a first priority security interest and hypothec over the present and after-acquired personal property of Aeroplan LP, subject to certain exclusions and permitted liens. Aeroplan LP's obligations in respect of the senior secured credit facilities will also be guaranteed by each of Aeroplan LP's general partner (Aeroplan GP), a subsidiary of the Corporation, and the Aeroplan Trust, with the Trust providing a first priority security interest over its present and after-acquired personal property, subject to certain exclusions and permitted liens, as security for its guarantee obligations, and with Aeroplan GP providing a pledge of its interests in Aeroplan LP as security for its guarantee obligations. The Aeroplan Trust is wholly owned by the Aeroplan Income Fund and holds a 14.4% interest in Aeroplan LP. The terms of the New Credit Facilities include certain covenants. The credit facilities are subject to Aeroplan's ability to maintain certain leverage, debt service and interest coverage covenants, as well as other affirmative and negative covenants.

(k) Air Canada entered into aircraft and engine lease transactions with several special purpose entities that qualify as VIEs. As a result of the adoption of AcG-15 as described in note 2, Air Canada has consolidated leasing entities covering 51 aircraft and 22 engines previously accounted for as operating leases. The debt has a weighted average effective interest rate of approximately 8%. The aircraft are charged as collateral against the debt by the owners thereof. The creditors under these leasing arrangements have recourse to Air Canada, as lessee, in the event of default or early termination of the lease. The majority of the VIEs are not Canadian based entities and hold debt amounting to US$965 ($1,125).

Aircraft related debt consolidated under AcG-15 is summarized as follows:	Final Maturity	2005
Canadair Regional Jet	2007-2011	$ 329
Boeing 767-300	2011-2016	231
Engines	2008	78
Airbus A319	2011-2014	331
Airbus A321	2017	156
		$ 1,125

(l) Under AcG-15, Air Canada is the primary beneficiary of certain of the Fuel Facilities Corporations. As a result of the adoption of AcG-15 as described in note 2, Air Canada consolidated three Fuel Facilities Corporations. The debt is secured by a general security agreement covering all assets of the Fuel Facilities Corporations.

(m) Capital lease obligations, related to computer equipment, facilities and 35 aircraft, total $1,365 ($87 and US$1,096). Future minimum lease payments are $1,989, which includes $624 of interest. The debt has a weighted average effective interest rate of approximately 8%. Final maturities range from 2008 to 2027. Certain aircraft lease agreements contain a fair value test, beginning on July 1, 2009, and annually thereafter until lease expiry. This test relates to 38 aircraft under lease of which 33 are accounted for as capital leases. Under the test, Air Canada may be required to prepay certain lease amounts, based on aircraft fair values, as of the date of the test. Any amounts prepaid are recoverable to the extent that aircraft fair values exceed certain thresholds and to the extent Air Canada has obtained residual value support on lease expiry. The maximum amount payable on July 1, 2009, assuming the related aircraft are worth nil, is US$871. This amount declines over time to nil upon lease expiry.

Interest paid on long-term debt and capital lease obligations in 2005 by the Corporation was $220 (2004 - $38). During the nine months ended September 30, 2004, the Predecessor Company paid interest expense of $131.

8. FUTURE INCOME TAXES

Significant components of the Corporation's future tax assets and liabilities are as follows:

	2005	2004
Future tax assets		
Non-capital loss carry forward	$ 793	$ 558
Post-employment obligations	748	775
Accounting provisions not currently deductible for tax	239	242
Tax basis of fixed assets over book basis	400	396
Eligible capital expenditures	19	40
Unearned revenues	31	372
Intangible assets	111	81
Net other	64	62
Total future tax assets	2,405	2,526
Future tax liabilities		
Intangible assets	388	435
Net future tax assets	2,017	2,091
Less valuation allowance	2,238	2,334
Net recorded future income tax liability	$ (221)	$ (243)

Future income tax assets are recognized to the extent that realization is considered more likely than not. Since the Corporation has determined that it is more likely than not that the future income tax assets are not recoverable, the net future tax assets have been offset by a valuation allowance. However, the future tax deductions underlying the future tax assets remain available for use in the future to reduce taxable income. The benefit of future income tax assets that existed at fresh start, and against which a valuation allowance is recorded, will be recognized first to reduce to nil any remaining intangible assets (on a pro-rata basis) that were recorded upon fresh start reporting with any remaining amount as a credit to shareholders' equity. The benefit of future income tax assets that arise after fresh start will be recognized in the income statement.

It has been assumed that certain intangibles with a carrying value of approximately $1,297, with no underlying tax cost, have indefinite lives and accordingly, the associated future income tax liability of $221 is not expected to reverse until the intangible assets are disposed of or become amortizable.

The reconciliation of income tax attributable to continuing operations, computed at the statutory tax rates, to income tax expense (recovery) is as follows:

	Successor Company		Predecessor Company
	Year Ended Dec 31, 2005	Period Ended Dec 31, 2004	Nine Months Ended Sept 30, 2004
Provision (recovery) based on combined federal and provincial tax rates	$ 132	$ 10	$ (304)
Non-taxable portion of capital gains	(2)	(3)	(4)
Large corporations tax	15	2	7
Non-deductible expenses	25	3	14
Non-taxable dilution gain on Aeroplan LP	(42)	-	-
Rate impact of the transfer of temporary difference attributable to Aeroplan from Air Canada to ACE	17	-	-
Effect of tax rate changes on future income taxes	-	-	(1)
Effect of statutory tax rates substantially enacted during the year	(38)	-	-
Other	1	-	(1)
	108	12	(289)
Valuation allowance	23	1	291
Provision for income taxes	$ 131	$ 13	$ 2

Significant components of the provision for income taxes attributable to continuing operations are as follows:

	Successor Company		Predecessor Company
	Year Ended Dec 31, 2005	Period Ended Dec 31, 2004	Nine Months Ended Sept 30, 2004
Current tax expense	$ 15	$ 2	$ 7
Future income tax expense (recovery) relating to temporary differences	131	10	(296)
Future income tax recovery from tax rate changes	(38)	-	-
Valuation allowance	23	1	291
Provision for income taxes	$ 131	$ 13	$ 2

Income taxes paid in 2005 by the Corporation were $23 (2004 - less than $1). Income taxes paid in 2004 by the Predecessor Company were less than $1.

The balances of tax attributes as at December 31, 2005, namely the balances of non capital loss carryforward, vary amongst different taxing jurisdictions. The following are the Federal tax loss expiry dates:

Year of expiry	Tax losses
2009	$ 11
2010	12
2011	-
2012	-
2013	-
2014	1,439
2015	904
	$ 2,366

9. PENSION AND OTHER BENEFIT LIABILITIES

The Corporation maintains several defined benefit and defined contribution plans providing pension, other retirement and post-employment benefits to its employees.

The Corporation is the administrator and sponsoring employer of ten Domestic Registered Plans ("Domestic Registered Plans") registered under the Pension Benefits Standard Act, 1985 (Canada). The US plan, UK plan and Japan plan are international plans covering employees in those countries. In addition, the Corporation maintains a number of supplementary pension plans, which are not registered. The defined benefit pension plans provide benefits upon retirement, termination or death based on the member's years of service and final average earnings for a specified period.

The other employee benefits consist of health, life and disability. These benefits consist of both post-employment and post-retirement benefits. The post-employment benefits relate to disability benefits available to eligible active employees, while the post-retirement benefits are comprised of health care and life insurance benefits available to eligible retired employees.

The measurement date used for financial reporting of the pension and other benefit obligations was revised to November 30 from December 31. The most recent actuarial valuation of the registered domestic pension plans was as of January 1, 2005 and the solvency deficit was $1,416. The next funding valuation will be as of January 1, 2006.

The accrued benefit liability is included in the balance sheet as follows:

	2005	2004
Pension benefits	$ 1,433	$ 1,563
Other employee future benefits	942	875
	2,375	2,438
Current portion	(221)	(94)
Pension and other benefit liabilities	$ 2,154	$ 2,344

The current portion of Pension benefits represents past service contributions for the Domestic Registered Plans, scheduled to be paid during 2006 while the current portion of Other employee future benefits is an estimate of the claims to be incurred during 2006. The current portion is included in Accounts payable and accrued liabilities.

Pension and other employee future benefit obligations are adjusted to reflect the net accrued benefit obligation based on management's best estimate assumptions on a going forward basis. The liability recorded is as follows:

	Pension Benefits			Other Benefits		
	Successor Company Dec 31, 2005	Successor Company Dec 31, 2004	Predecessor Company Sept 30, 2004	Successor Company Dec 31, 2005	Successor Company Dec 31, 2004	Predecessor Company Sept 30, 2004
Change in benefit obligation						
Benefit obligation at beginning of period	$ 11,207	$ 10,783	$ 10,873	$ 842	$ 866	$ 819
Current service cost	202	46	139	85	23	69
Interest cost	650	163	468	50	13	40
Employees' contributions	80	24	67	-	-	-
Benefits paid	(592)	(133)	(387)	(63)	(18)	(53)
Actuarial (gain) loss	1,419	331	(370)	31	(34)	(9)
Foreign exchange	(45)	(7)	(7)	(5)	(8)	-
Benefit obligation at end of period	**12,921**	**11,207**	**10,783**	**940**	**842**	**866**
Change in plan assets						
Fair value of plan assets at beginning of period	9,673	9,149	9,022	10	10	10
Actual return on plan assets	1,016	533	301	1	1	-
Employer contributions	284	106	151	54	17	45
Employees' contributions	80	24	67	-	-	-
Benefits paid	(592)	(133)	(387)	(51)	(18)	(45)
Foreign exchange	(40)	(6)	(5)	-	-	-
Fair value of plan assets at end of period	**10,421**	**9,673**	**9,149**	**14**	**10**	**10**
Deficit at end of period	2,500	1,534	1,634	926	832	856
Employer contributions after measurement date	(6)	-	-	(5)	-	-
Unrecognized past service cost	-	-	(605)	-	-	(30)
Unrecognized net actuarial gain (loss)	(1,061)	29	(957)	21	43	(190)
Net benefit obligation	**1,433**	**1,563**	**72**	**942**	**875**	**636**
Current portion	199	82	-	22	12	12
Pension and other benefits liability	**$ 1,234**	**$ 1,481**	**$ 72**	**$ 920**	**$ 863**	**$ 624**
Weighted average assumptions used to determine the accrued benefit liability						
Discount rate	5.00%	5.75%	6.00%	4.50%-5.75%	4.75%-5.75%	6.00%
Rate of compensation increase	4.00%	4.00%	4.00%			

The deficit at the end of the period by plan is as follows:

	December 31, 2005	December 31, 2004
Domestic Registered Plans	$ 1,657	$ 824
US, UK and Japan	76	66
Supplementary plans	767	644
	$ 2,500	**$ 1,534**

The deficit, on an accounting basis, at December 31, 2005 for pension benefits was $2,500 compared to $1,534 at December 31, 2004. Actuarial losses on the benefit obligation of $1.4 billion were partially offset by employer past service contributions of $99 and actual returns on plan assets which were greater than expected. Of the actuarial losses, $1.2 billion were due to the change in discount rate from 5.75% to 5%, and the remainder due to the increase in expected lives assumed in the mortality table and other factors.

On August 9, 2004, the Government of Canada adopted the Air Canada Pension Plan Solvency Deficiency Funding Regulations (the "Pension Regulations"). The Pension Regulations allow Air Canada to fund the solvency deficiencies in its Domestic Registered Plans as of January 1, 2004 over ten years, rather than the five years required under the ordinary rules, and to pay down such deficiencies by way of an agreed schedule of variable annual contributions rather than by way of equal annual contributions as required under the ordinary rules. The Pension Regulations came into force upon Air Canada's emergence from CCAA protection on September 30, 2004, on which date the Company issued subordinated secured promissory notes in an aggregate amount of approximately $347 in favor of the pension plan trustee. Such notes will be reduced as the principal amount of the solvency deficiencies is paid down, and will only be called on the occurrence of certain specified events of default. The amount of secured promissory notes outstanding as at December 31, 2005 is $329. The effect of the issuance of the subordinated security promissory notes is included within the fair value of the obligation for pension benefits as reflected in the Corporation's balance sheet.

The cash payments with respect to the pension plans are estimated to be $389 for 2006 as follows:

Domestic Registered Plans	$	337
US, UK and Japan		12
Supplementary plans		40
	$	**389**

The Domestic Registered Plan assets consist of the following:

	Percentage of plan assets		
	November 30, 2005	December 31, 2004	Target Allocation
Equity securities	62.3%	64.8%	65.0%
Bonds and mortgages	32.1%	33.1%	35.0%
Real estate	0.1%	0.2%	0.0%
Short-term and Other	5.5%	1.9%	0.0%
Total	**100.0%**	**100.0%**	**100.0%**

For the Domestic Registered Plans, the investments conform to the Statement of Investment Policy and Objectives of the Air Canada Pension Master Trust Fund. The Audit, Finance and Risk Committee of the Board of Directors reviews and confirms the policy annually. The investment return objective of the fund is to achieve a total annualized rate of return that exceeds inflation by at least 3.75% over the long term.

In addition to the broad asset allocation, as summarized in the asset allocation section above, the following policies apply to individual asset classes:

- Equity investments can include convertible securities, and are required to be diversified among industries and economic sectors. Foreign equities can comprise 27% to 33% of the total market value of the trust. Limitations are placed on the overall allocation to any individual security at both cost and market value. Derivatives are permitted to the extent they are not used for speculative purposes or to create leverage.

- Fixed income investments are oriented toward risk averse, long term, investment grade securities rated "A" or higher. With the exception of Government of Canada securities or a province thereof, in which the plan may invest the entire fixed income allocation, fixed income investments are required to be diversified among individual securities and sectors. The target return is comprised of 50% of the total return of the Scotia Capital Universe Bond Index and 50% of the total return of the Scotia Capital Long Term Bond Index.

Similar investment policies are established for the other pension plans sponsored by Air Canada.

Air Canada's expected long-term rate of return on assets assumption is selected based on the facts and circumstances that exist as of the measurement date, and the specific portfolio mix of plan assets. Management reviewed anticipated future long-term performance of individual asset categories and considered the asset allocation strategy adopted by the company, including the longer duration in its bond portfolio in comparison to other pension plans. These factors are used to determine the average rate of expected return on the funds invested to provide for the pension plan benefits. While the review considers recent fund performance and historical returns, the assumption is primarily a long-term, prospective rate.

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

	Pension Benefits			Other Benefits		
	Successor Company Dec 31, 2005	Successor Company Dec 31, 2004	Predecessor Company Sept 30, 2004	Successor Company Dec 31, 2005	Successor Company Dec 31, 2004	Predecessor Company Sept 30, 2004
Components of Net Periodic Pension Cost						
Current service cost	$ 202	$ 46	$ 139	$ 85	$ 23	$ 69
Interest cost	650	163	468	50	13	40
Actual return on plan assets	(973)	(533)	(301)	(1)	(1)	-
Actuarial loss (gain) on benefit obligation	1,362	331	(370)	19	(34)	(9)
Costs arising in the period	**1,241**	**7**	**(64)**	**153**	**1**	**100**
Differences between costs arising in the period and costs recognized in the period in respect of:						
Return on plan assets	281	360	(186)	-	-	-
Actuarial loss (gain)	(1,362)	(331)	390	(23)	34	20
Plan amendments/prior service cost	-	-	67	-	-	5
Transitional obligation (asset)	-	-	(6)	-	-	-
	(1,081)	**29**	**265**	**(23)**	**34**	**25**
Negative balances due to limit	-	-	4	-	-	-
Net periodic pension cost recognized	**$ 160**	**$ 36**	**$ 205**	**$ 130**	**$ 35**	**$ 125**
Weighted average assumptions used to determine pension costs						
Discount rate	5.75%	6.00%	6.00%	4.5%-5.75%	4.75%-5.75%	6.00%
Expected long term rate of return on plan assets	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%
Rate of compensation increase	4.00%	4.00%	4.00%			

DEFINED CONTRIBUTION PLAN

The Corporation's management, administrative and certain unionized employees may participate in a defined contribution plan. The employee's contributions range from 3% to 6% of earnings with the Corporation contributing an equal amount. The expense for the defined contribution plan recorded by the Corporation is $6 (2004 $1). The expense for the defined contribution plan recorded by the Predecessor Company was $3 in 2004.

OTHER BENEFITS - SENSITIVITY ANALYSIS

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 10% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2005 (2004 10.75%). The rate is assumed to decrease gradually to 5% by 2013. A one percentage point increase in assumed health care trend rates would have increased the service and interest costs by $1 and the obligation by $15. A one percentage point decrease in assumed health care trend rates would have decreased the service and interest costs by $1 and the obligation by $20.

10. OTHER LONG-TERM LIABILITIES

	2005	2004
Aeroplan deferred revenues [(a)]	$ 953	$ 977
Unfavourable contract liability on aircraft leases [(b)]	107	290
Long-term employee liabilities [(c)]	109	130
Aircraft rent in excess of lease payments	126	33
Other	104	90
Other long-term liabilities	**$ 1,399**	**$ 1,520**

(a) The current portion of Aeroplan deferred revenues of $680 (2004 $622) are reported in Aeroplan deferred revenues.

(b) The unfavourable contract liability on aircraft leases represents the net present value of lease payments in excess of estimated market rents related to lease arrangements that existed on fresh start reporting. The liability was decreased by $155 as a result of the adoption of AcG-15 as described in note 2.

(c) The following table outlines the changes to the labour related provisions which include those related to restructuring:

	Successor Company		Predecessor Company
	Year Ended Dec 31, 2005	Period Ended Dec 31, 2004	Nine Months Ended Sept 30, 2004
Beginning of period	$ 192	$ 198	$ 121
Charges recorded	10	2	117
Amounts disbursed	(45)	(8)	(40)
End of period	**$ 157**	**$ 192**	**$ 198**
Current portion	48	62	68
Long-term employee liabilities	**$ 109**	**$ 130**	**$ 130**

The current portion is included in Accounts payable and accrued liabilities. An involuntary severance program pertaining to the Predecessor and Corporation's workforce reduction plan with respect to non-unionized employees was approved by Management in 2003. Implementation of the plan began in May 2003 and is expected to continue into 2006.

Implementation of the workforce reduction plan pertaining to the Predecessor Company's unionized employees commenced in the second quarter of 2003 as a result of agreed modifications to all collective agreements between employee unions and the Company. Further agreed modifications to all collective agreements were reached in July 2004. The modifications to certain collective agreements include voluntary severance programs ("VSP"). For those VSP which will be offered to the members of the affected employee unions over the next several years, the estimated cost of the VSP is approximately $47 and will be recorded as a liability and a salary and wage expense as the affected employees accept the offer.

11. STOCK BASED COMPENSATION

ACE maintains a stock option plan for certain employees. Plan participation is limited to employees holding positions that, in ACE Board's view (or a committee selected by the Board), have a significant impact on ACE's long-term results. During 2005, the plan was amended to increase the number of shares that are available for issuance to reflect the greater number of shares outstanding as a result of the new issue of shares and convertible debt in the second quarter. The number of shares available for issuance under this plan has increased from 5,052,545 (approximately 5% of the fully diluted equity of ACE at the time the plan was adopted) to a maximum of 6,078,882 shares (approximately 5% of the fully diluted equity of ACE as at December 31, 2005). The stock option plan provides that the options will have an exercise price of not less than 100% of the market price of the underlying shares at the time of grant.

During 2005, ACE granted options to purchase 770,000 (period ended December 31, 2004: 3,027,509 options granted) shares with a weighted average exercise price of $39.44 (2004 – $20.00) per common share. The fair value of stock options granted is recognized as a charge to salary and wage expense over the applicable vesting period, with an offset to contributed surplus. Fifty percent of all options vest over four years. The remaining options will vest based upon performance conditions over the same time period. All options expire after seven years. When options are exercised, the consideration paid by employees, together with the amount in contributed surplus, is credited to share capital.

The assumptions used to determine stock-based compensation expense, using the Black-Scholes option valuation model were as follows:

	2005	2004
Compensation expense ($ millions)	$ 6	$ 1
Number of stock options granted	770,000	3,027,509
Weighted average fair value per option granted ($)	$ 9.46	$ 7.73
Aggregated fair value of options granted ($ millions)	$ 7	$ 23
Weighted average assumptions:		
Risk-free interest rate	3.40%	3.90%
Expected volatility	35%	52%
Dividend yield	0%	0%
Expected option life (years)	4.5	4.5

In 2005, ACE issued 521,976 common shares on the exercise of stock options for cash consideration of $10.

In 2005, the amount credited to share capital for stock-based compensation was $11. The amount credited to contributed surplus was $5.

At December 31, 2005, a total of 3,186,908 (2004 – 3,027,509) stock options were outstanding, and represented approximately 2.61% (2004 2.99%) of ACE's fully diluted equity, which was within the Corporation's guideline of 5%.

A summary of the Corporation's stock option plan and activity is as follows:

	2005			2004		
	Shares (000)	Weighted Average Exercise Price/Share		Shares (000)	Weighted Average Exercise Price/Share	
Common Shares						
Beginning of period	3,028	$	20.00	-	$	-
Granted	770		39.44	3,028		20.00
Exercised	(522)		20.00	-		-
Forfeited	(89)		20.00	-		-
Outstanding options, end of year	**3,187**	**$**	**24.70**	**3,028**	**$**	**20.00**
Options exercisable, end of year	**162**	**$**	**23.95**	**-**	**$**	**20.00**

		2005 Outstanding Options				2005 Exercisable Options			
Range of Exercisable Prices	Expiry Dates	Number of Exercisable Options	Weighted Average Remaining Life (years)	Weighted Average Exercise Price/Share		Number of Exercisable Options	Weighted Average Remaining Life (years)		
$ 20.00	2011	2,416,908	6	$	20.00	129,923	$	20.00	
$ 34.11 - $ 41.62	2012	770,000	7	$	39.44	32,292	$	39.87	
		3,186,908		**$**	**24.70**	**162,215**	**$**	**23.95**	

PREDECESSOR COMPANY

In the Predecessor Company's stock option plan, eligible employees were granted options to purchase common shares and Class A shares, at a price not less than the market value of the shares at the date of granting. All outstanding options of the Predecessor Company were cancelled in 2004 without payment or consideration (7,300,000 common shares with a weighted average exercise price of $9.05 and 2,316,000 Class A shares with a weighted average exercise price of $6.54).

12. SHARE CAPITAL AND OTHER EQUITY

The issued and outstanding common shares of ACE as at December 31, 2005, along with potential common shares, are as follows:

	Authorized	2005 Outstanding (000)	2004 Outstanding (000)
Issued and outstanding common shares			
Class A variable voting shares [(a)]	unlimited	76,735	74,813
Class B voting shares [(b)]	unlimited	25,059	8,813
Shares held in escrow [(Note 19)]		28	5,189
Total issued and outstanding common shares		**101,822**	**88,815**
Potential common shares			
Convertible preferred shares [(c)]		10,228	9,375
Convertible notes [(d)]		6,875	-
Stock options		3,187	3,028
		20,290	**12,403**

Share capital and other equity is comprised of:

(a) Class A Variable Voting Shares

The Class A Variable Voting Shares may be held only by persons who are not Canadians and are entitled to one vote per Class A Variable Voting Share unless (i) the number of Class A Variable Voting Shares outstanding (including the Convertible Preferred Shares, on an as-converted basis), as a percentage of the total number of votes attaching to voting shares outstanding exceeds 25% or (ii) the total number of votes cast by or on behalf of holders of Class A Variable Voting Shares (including the Convertible Preferred Shares on an as-converted basis) at any meeting exceeds 25% of the total number of votes that may be cast at such meeting. If either of the above noted thresholds would otherwise be surpassed at any time, the vote attached to each Class A Variable Voting Share will decrease proportionately such that (i) the Class A Variable Voting Shares as a class (including the Convertible Preferred Shares on an as-converted basis) do not carry more than 25% of the aggregate votes attached to all issued and outstanding voting shares of ACE and (ii) the total number of votes cast by or on behalf of holders of Class A Variable Voting Shares (including the Convertible Preferred Shares on an as-converted basis) at any meeting do not exceed 25% of the votes that may be cast at such meeting.

(b) Class B Voting Shares

The Class B Voting Shares may be held only by persons who are Canadians. Each Class B Voting Share shall confer the right to one (1) vote in person or by proxy at all meetings of shareholders of the ACE.

(c) Convertible Preferred Shares

As at September 30, 2004, 12,500 Convertible Preferred Shares were issued to an affiliate of Cerberus for consideration of $250 before fees of $12. These Convertible Preferred Shares are convertible into 10,228,441 common shares, based on the conversion ratio applicable as at December 31, 2005.

For accounting purposes, the Convertible Preferred Shares are presented as a compound instrument. At the date of issuance, the value ascribed to the holders' conversion option, which is presented as equity, was $123 less allocated fees of $6; the value ascribed to the financial liability was $127. The Convertible Preferred Shares will increase by 5% per annum, compounded semi-annually from the date of issuance ("Fully Accreted Value") resulting in an accretion on the financial liability at effective interest rate of 12%.

Each preferred share shall confer on its holder the right to that number of votes as is equal to the number of ACE shares into which each preferred share held by such holder could be converted on the date for determination of shareholders entitled to vote at the meeting or on the date of any written consent, based on the conversion ratio in effect on such date; provided, however, that if any Convertible Preferred Shares are held by persons who are not Canadians, such Convertible Preferred Shares shall be subject to the same proportionate reduction in voting percentage as described for Class A Variable Voting Shares above as if, for voting purposes only, such Convertible Preferred Shares had been converted into Class A Variable Voting Shares.

The Convertible Preferred Shares may be converted at any time, at the option of the holder thereof, into fully paid and non-assessable Class B Voting Shares (if the holder is a Canadian) or fully paid and non-assessable Class A Variable Voting Shares (if the holder is not a Canadian) at the conversion ratio applicable upon the date of conversion. The conversion price is initially equal to 135% of the subscription price of each Class B Voting Share under the Rights Offering. The conversion price was adjusted automatically downward on the first anniversary of the issuance date of the Convertible Preferred Shares to 130% of the subscription price of each ACE Class B Voting Share. The conversion is based upon the Fully Accreted Value at the time of conversion.

Mandatory Conversion

The holders of ACE Convertible Preferred Shares would have been required to convert the ACE Convertible Preferred Shares into fully paid and non-assessable common shares at the conversion ratio applicable upon the date of conversion, if at any time during the period between the effective date until and including the first anniversary thereof, the closing price of the ACE shares on the principal market for each of thirty consecutive trading days exceeded 200% of the then applicable conversion price.

Following the first anniversary of the effective date, the holders of ACE Convertible Preferred Shares will be required to convert the ACE Convertible Preferred Shares into fully paid and non-assessable common shares at the conversion ratio applicable upon the date of conversion, if the closing price of the ACE shares on the principal market for each of thirty consecutive trading days exceeded 175% of the then applicable conversion price.

The Convertible Preferred Shares will also be subject to mandatory conversion into fully paid and non-assessable common shares within ten days of each mandatory conversion date, at the conversion ratio applicable upon the date of conversion, upon the following terms and conditions:

- if the closing price of the ACE shares on the principal market exceeds the Fully Accreted Value of a preferred share on at least thirty of the one hundred trading days immediately prior to a particular mandatory conversion date; or

- if the closing price of the ACE shares on the principal market does not exceed the Fully Accreted Value of a preferred share on at least thirty of the one hundred trading days immediately prior to a particular mandatory conversion date, (i) the holders of the Convertible Preferred Shares will not be required to convert their Convertible Preferred Shares into ACE shares and (ii) as of such mandatory conversion date, the then applicable conversion price shall be automatically reduced by 3.75%; and

- if the closing price of the ACE shares on the principal market does not exceed the Fully Accreted Value of a preferred share on at least thirty of the one hundred trading days immediately prior to the final maturity date, then holders of Convertible Preferred Shares will be entitled, upon written notice to ACE given within ten days following the final maturity date, to require ACE to redeem each of the Convertible Preferred Shares in cash at a redemption price equal to the Fully Accreted Value as of the final maturity date.

The first mandatory conversion date is seven years from the date of issuance.

The Convertible Preferred Shares (including the shares into which they are convertible) may not be sold, assigned or in any way transferred by Cerberus (other than to its affiliates) including pursuant to hedging transactions, swaps or other arrangements transferring any of the economic consequences of the ownership of the Convertible Preferred Shares acquired by Cerberus for a period of 24 months after the closing; provided that, if at any time during such 24 month period Cerberus is required to convert the Convertible Preferred Shares, then the restrictions on transfer with respect to 50% of the Convertible Preferred Shares (and any shares into which they are converted or convertible) shall be of no force and effect and the restrictions on transfer with respect to the remaining 50% of the Convertible Preferred Shares (and any shares into which they are converted or convertible) shall be limited only to sales of beneficial ownership of the Convertible Preferred Shares (and any shares into which they are convertible) to third parties. Notwithstanding the foregoing, the transfer restrictions shall cease to be in effect as to all Convertible Preferred Shares (and any shares into which they are convertible) in the event of a tender offer for any of the shares of ACE, any change in control transaction, any liquidation, dissolution, bankruptcy or other similar proceedings of ACE.

Subject to the rights, privileges, restrictions and conditions attaching to the shares of ACE ranking prior to the Convertible Preferred Shares, upon the liquidation, dissolution or winding-up or distribution of the assets of ACE, the holders of the Convertible Preferred Shares will be entitled to receive, prior to and in preference to the holders of ACE shares, an amount equal to the Fully Accreted Value of the Convertible Preferred Shares as of the date of the liquidation, dissolution, winding-up or distribution.

The holders of Convertible Preferred Shares participate on an as-converted basis with respect to all dividends, distributions, spin-off, split-off, subscription rights or other offers made to holders of Class A Variable Voting Shares and Class B Voting Shares and any other similar transactions.

(d) Convertible Notes
During 2005, the Corporation issued $330 of Convertible Senior Notes due 2035 ("Convertible Notes") for net proceeds of $319. For accounting purposes, the Convertible Notes are presented as a compound instrument with the conversion option reflected in other equity above. Refer to note 7a for additional information.

Share capital and other equity summary as at December 31, 2005 (net of issue costs)

		2005		2004
Common shares [e]	$	2,231	$	1,778
Convertible preferred shares [c]		117		117
Convertible notes [d]		92		-
		2,440		**1,895**
Adjustment to shareholders' equity [f]		(1,693)		(1,708)
Share capital and other equity	$	747	$	187

(e) The carrying value of outstanding common shares as at December 31, 2004 includes the net proceeds received under the Rights Offering and Standby Purchase Agreement of $852 and the fair value of common shares issued to creditors under the Plan of $925 based upon the issue price from the Rights Offering. Issue of common shares during the period ended December 31, 2004 was $1. In 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 ($442 net of fees). During 2005, the Company issued 521,976 common shares on the exercise of stock options for cash consideration of $10.

(f) Under fresh start reporting, the balance in shareholders' equity after a comprehensive revaluation is adjusted to the net value of identifiable assets and liabilities. CICA 1625 - Comprehensive Revaluation of Assets and Liabilities, does not permit goodwill to be recorded even if the fair value of net assets is less than the fair value of the enterprise as a whole. During the year ended December 31, 2005, an adjustment of $15 was recorded in shareholders' equity related to fresh start reporting. Management has assessed this adjustment as not material to the financial statements, as a whole, for the periods presented or for prior periods that have been previously reported.

The changes during 2005 in the outstanding number of common shares and their aggregate stated value were as follows:

	2005		
	Number (000)		Amount
Issued, beginning of year	88,815	$	1,778
Shares issued under equity offering	12,485		442
Shares issued under option	522		11
Issued, end of year	**101,822**	**$**	**2,231**

13. AEROPLAN

DISPOSAL OF INTERESTS IN AEROPLAN

On June 29, 2005, Aeroplan Limited Partnership ("the Predecessor LP") transferred substantially all of its assets and liabilities into a newly created Aeroplan Limited Partnership ("Aeroplan LP") in exchange for the issuance of 175 million units of Aeroplan LP and the issuance of two promissory notes (the Acquisition Promissory Note in the amount of $125 and the Working Capital Note in the amount of $186). The Predecessor LP was liquidated into ACE at closing. The Acquisition Promissory Note was settled on June 29, 2005 from the proceeds of the offering. The Working Capital Note which was due October 31, 2005, was repaid during the third quarter. These transactions and events did not have any accounting consequences on the consolidated financial statements.

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

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

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

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

CASH RESERVES OF AEROPLAN

In conjunction with the issuance of Units to the Aeroplan Income Fund and the bank financing (refer to note 7j) entered into on June 29, 2005, Aeroplan LP established the Aeroplan Miles Redemption reserve ("the Reserve"). As at December 31, 2005, the Reserve was $400 of which $301 is included in cash and cash equivalents and $99 is included in short-term investments. The amount to be held in the Reserve, as well as the types of securities it may be invested in, are based on policies established by management of Aeroplan LP, which will be reviewed periodically. The Reserve may be used to supplement cash flows generated from operations in order to pay for rewards during unusually high redemption activity associated with Aeroplan Miles. Under the terms of the term facility, described in note 7j, Aeroplan LP was required to deposit the borrowed funds of $300 into the Reserve. Any deposits of funds in non-Canadian dollar denominated investments have to be hedged.

14. EARNINGS PER SHARE

The following table outlines the calculation of basic and diluted earnings per share (in millions, except per share amounts):

	Successor Company		Predecessor Company
	Year Ended Dec 31, 2005	Period Ended Dec 31, 2004	Nine Months Ended Sept 30, 2004
Numerator:			
Numerator for basic earnings per share:			
Income (loss) from continuing operations	$ 258	$ 15	$ (895)
Effect of potential dilutive securities:			
After tax income from:			
Convertible preferred shares	11	3	-
Convertible notes	15	-	-
Convertible subordinated debentures	-	-	8
Add back anti-dilutive impact	(15)	(3)	(8)
Adjusted earnings (loss) for diluted earnings per share	**$ 269**	**$ 15**	**$ (895)**
Denominator:			
Denominator for basic earnings per share:			
Weighted-average shares	98	89	120
Effect of potential dilutive securities:			
Stock options	1	1	-
Convertible preferred shares	10	9	-
Convertible notes	5	-	-
Class A non-voting preferred shares	-	-	10
Convertible subordinated debentures	-	-	9
	16	10	19
Add back anti-dilutive impact	(5)	(9)	(19)
Denominator for diluted earnings per share:			
Adjusted weighted-average shares	109	90	120
Basic earnings (loss) per share:	**$ 2.63**	**$ 0.17**	**$ (7.45)**
Diluted earnings (loss) per share:	**$ 2.46**	**$ 0.17**	**$ (7.45)**

The calculation of earnings per share is based on whole dollars and not on rounded millions. As a result, the above amounts may not be recalculated to the per share amount disclosed above.

Pursuant to the Plan as further described in note 19, 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 note 12.

The dilutive effect of outstanding stock options on earnings per share is based on the application of the treasury stock method. For the Corporation, under the treasury stock method, the proceeds from the exercise of such securities are assumed to be used to purchase Class B Voting Shares. For the Predecessor Company, proceeds were assumed to be used to purchase common shares and Class A shares.

Excluded from the calculation of diluted earnings per share were 750,000 outstanding options as the options' exercise price was greater than the average market price of the common shares for the year.

15. SEGMENT INFORMATION

As outlined in note 1, the Corporation has four reportable segments: Transportation Services, Aeroplan, Jazz, and ACTS. In the Predecessor Company, technical services was a cost centre within Air Canada and discrete financial information is currently not available. As described in note 1, a capacity purchase agreement between Air Canada and Jazz came into effect on September 30, 2004. The Jazz segment information in the Corporation is not directly comparable as a result of this new agreement.

As described in note 2, the Corporation changed the accounting as of September 30, 2004 for the recognition of its revenues relating to the loyalty program. As a result, Aeroplan results are not comparable to prior periods.

The accounting policies for each of these segments are the same as those described in note 2. Segment financial information has been prepared consistent with how financial information is produced internally for the purposes of making operating decisions as further described in note 1. Segments negotiate transactions between each other as if they were unrelated parties. A reconciliation of the total amounts reported by each segment to the applicable amounts in the consolidated financial statements follows:

	Successor Company Year ended December 31, 2005					
	Transportation Services [a]	Aeroplan [b]	Jazz [c]	ACTS	Inter-Segment Elimination	Consolidated Total
Passenger revenue	$ 8,269	$ -	$ -	$ -	$ -	$ 8,269
Cargo revenue	620	-	-	-	-	620
Other revenue	117	627	10	187	-	941
External revenue	**9,006**	**627**	**10**	**187**	**-**	**9,830**
Inter-segment revenue	194	13	1,013	567	(1,787)	-
Total revenue	**9,200**	**640**	**1,023**	**754**	**(1,787)**	**9,830**
Aircraft rent	343	-	80	-	(6)	417
Depreciation, amortization, and obsolescence	424	8	18	32	-	482
Other operating expenses	8,259	530	796	675	(1,781)	8,479
Total operating expenses	**9,026**	**538**	**894**	**707**	**(1,787)**	**9,378**
Operating income	174	102	129	47	-	452
Total non-operating income (expense), non-controlling interest, foreign exchange, and income taxes	(167)	(2)	(11)	(14)	-	(194)
Segment Results	**$ 7**	**$ 100**	**$ 118**	**$ 33**	**$ -**	**$ 258**
Total assets	$ 11,001	674	504	381	(713)	$ 11,847
Additions to capital assets	$ 849	12	16	5	-	$ 882

	Successor Company Period ended December 31, 2004					
	Transportation Services [(a)]	Aeroplan [(b)]	Jazz [(c)]	ACTS	Inter-Segment Elimination	Consolidated Total
Passenger revenue	$ 1,681	$ -	$ -	$ -	$ -	$ 1,681
Cargo revenue	151	-	-	-	-	151
Other revenue	44	121	3	62	-	230
External revenue	**1,876**	**121**	**3**	**62**	**-**	**2,062**
Inter-segment revenue	54	6	185	106	(351)	-
Total revenue	**1,930**	**127**	**188**	**168**	**(351)**	**2,062**
Aircraft rent	103	-	9	-	(1)	111
Depreciation, amortization, and obsolescence	73	1	4	7	-	85
Other operating expenses	1,812	104	153	150	(350)	1,869
Total operating expenses	**1,988**	**105**	**166**	**157**	**(351)**	**2,065**
Operating income	(58)	22	22	11	-	(3)
Total non-operating income (expense), foreign exchange, and income taxes	26	-	(4)	(4)	-	18
Segment Results	**$ (32)**	**$ 22**	**$ 18**	**$ 7**	**$ -**	**$ 15**

Subsequent to the dilution in interests in Aeroplan, as described in note 13, a non-controlling interest charge is recorded upon the consolidation of Aeroplan. As Aeroplan's non-controlling interest 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 earnings for the period or the amount of distributions to the non-controlling interest holder during the period.

(a) Includes transportation revenues for services provided both on Air Canada and Jazz aircraft and costs for Air Canada operations and fees charged by Jazz under the capacity purchase agreement, as well as Air Canada Cargo, Air Canada Groundhandling, Air Canada Vacations, and ACE. Inter-segment revenue includes management fees and costs and operating services charged to the other segments. Interest expense in the Transportation Services segment represents interest on all third party debt, except for interest on debt directly issued by Aeroplan and Jazz. 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 Aeroplan 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 travel, to the consolidated accounting policy of revenue recognition at the time reward transportation is provided. In addition, Aeroplan records revenue from the redemption of Miles in Other revenue, whereas on the consolidated financial statements, Miles redeemed for travel on Air Canada and Jazz are recorded in Passenger revenue. In the Aeroplan segment information, the cost to Aeroplan of purchasing rewards is recorded in other operating expenses. The adjustment for these items for the year ended December 31, 2005 is an add back of $370 to Other revenue and Other operating expenses.

(b) Other revenue includes revenue recognized on redemption of points accumulated through both air and third party contracts. Inter-segment revenue of $13 ($6 for the period ended December 31, 2004) represents the management fee charged to Air Canada by Aeroplan relating to tier management, marketing and other services related to the management of Air Canada's loyalty program.

(c) Includes Jazz operations under the capacity purchase agreement effective September 30, 2004.

	Predecessor Company Nine months ended September 30, 2004				
	Transportation Services	Aeroplan	Jazz [d]	Inter-Segment Elimination	Consolidated Total
Passenger revenue	$ 5,036	$ -	$ 592	$ -	$ 5,628
Cargo revenue	393	-	12	-	405
Other revenue	457	343	5	-	805
External revenue	**5,886**	**343**	**609**	**-**	**6,838**
Inter-segment revenue	367	48	7	(422)	-
Total revenue	**6,253**	**391**	**616**	**(422)**	**6,838**
Aircraft rent	498	-	27	(4)	521
Depreciation, amortization, and obsolescence	286	3	23	-	312
Other operating expenses	5,416	310	577	(418)	5,885
Total operating expenses	**6,200**	**313**	**627**	**(422)**	**6,718**
Operating income (loss) before reorganization and restructuring items	53	78	(11)	-	120
Reorganization and restructuring items	(815)	-	(56)	-	(871)
	(762)	**78**	**(67)**	**-**	**(751)**
Total non-operating income (expense), foreign exchange and income taxes	(131)	1	(14)	-	(144)
Segment Results	**$ (893)**	**$ 79**	**$ (81)**	**$ -**	**$ (895)**

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

	Successor Company		Predecessor Company
	Year Ended Dec 31, 2005	Period Ended Dec 31, 2004	Nine Months Ended Sept 30, 2004
Passenger revenue			
Canada	$ 3,447	$ 713	$ 2,236
US Transborder	1,570	321	1,160
Atlantic	1,727	318	1,212
Pacific	934	204	650
Other	591	125	370
Total passenger revenue	**$ 8,269**	**$ 1,681**	**$ 5,628**

GEOGRAPHIC INFORMATION

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

PROPERTY AND EQUIPMENT

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

16. COMMITMENTS

In 2004, Air Canada signed definitive purchase agreements with Empresa Brasileira de Aeronautica S.A. ("Embraer"), and Bombardier Inc. ("Bombardier") for the acquisition of regional jet aircraft. In November 2005, Air Canada also concluded agreements with The Boeing Company ("Boeing") for the acquisition of Boeing 777 and Boeing 787 aircraft.

BOEING

On November 9, 2005, Air Canada announced agreements with Boeing for the acquisition of up to 36 Boeing 777s and up to 60 Boeing 787 Dreamliners. The 36 Boeing 777s include firm orders for 18 aircraft plus purchase rights for 18 more, in a yet-to-be determined mix of the 777 family's newest models. Delivery of the first seven 777 aircraft is scheduled for 2007, commencing in March. The 60 Boeing 787 Dreamliners includes firm orders for 14 aircraft plus options and purchase rights for an additional 46 aircraft. Air Canada's first 787 is scheduled for delivery in 2010. The Corporation has received financing commitments from Boeing and the engine manufacturer covering all firm aircraft orders for approximately 90 percent of the capital expenditure.

EMBRAER

The agreement with Embraer covers firm orders for 15 Embraer 175 series aircraft as well as 45 Embraer 190 series aircraft. The purchase agreement also contains rights to exercise options for up to 60 additional Embraer 190 series aircraft as well as providing for conversion rights to other Embraer models.

Deliveries of the 15 Embraer 175 series aircraft commenced in July 2005 and the last aircraft was delivered in January 2006. All Embraer 175 deliveries were 80 percent financed by a third party.

The Embraer 190 series deliveries commenced in December 2005. At December 31, 2005, three of the Embraer 190 series firm aircraft orders have been completed and the remaining 42 deliveries are planned to be completed by January 2008. For the first 18 firm Embraer 190 deliveries, the Corporation has received loan commitments from a syndicate of banks and the manufacturer covering 80 percent of the capital expenditure. For the remaining 27 firm Embraer 190 deliveries, the Corporation has received loan commitments from the manufacturer covering 85 percent of the capital expenditures.

BOMBARDIER

The agreement with Bombardier covered firm orders for 15 Bombardier CRJ700 Series 705 aircraft and 15 Bombardier CRJ200 aircraft, all of which were delivered by the end of 2005. The agreement with Bombardier contains orders for 15 additional Bombardier CRJ200 aircraft which can be cancelled without penalty. The agreement also contains options for an additional 45 aircraft. As of February 9, 2006, no commitments have been made on the cancellable orders or on the additional options for 45 aircraft. The Corporation will also receive financing commitments of 85 percent of capital expenditures from the manufacturer on the cancellable aircraft orders should the Corporation decide to commit to acquire these aircraft.

AIRCRAFT RECONFIGURATION

On November 10, 2005, Air Canada announced its intention to provide all-new seating across its entire fleet, featuring state-of-the-art lie-flat seats for its international Executive First customers. In addition, Air Canada is outfitting its Executive Class cabins on North American routes with new premium seats, and all of its Hospitality cabins fleet-wide will be reconfigured with new seats offering personal seat back entertainment systems with an increased choice of audio and video programming.

CAPITAL COMMITMENTS

The estimated aggregate cost of the future firm deliveries as well as other capital purchase commitments approximates $6,055 excluding the 15 Bombardier CRJ200 aircraft which may be cancelled without penalty. US dollar amounts are converted using the December 31, 2005 noon day rate of CDN$1.1659. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day LIBOR rate at December 31, 2005. Committed payments are as follows:

2006	$	826
2007		1,950
2008		1,213
2009		428
2010		837
Thereafter		801
	$	6,055

OPERATING LEASE COMMITMENTS

Future minimum lease payments under existing operating leases of aircraft and other property amount to $3,416 (December 31, 2004 $3,347) using period end exchange rates.

	Aircraft	Other Property
2006	$ 458	$ 83
2007	406	68
2008	335	51
2009	300	37
2010	259	28
Thereafter	1,237	154
	$ 2,995	**$ 421**

Lease payments for aircraft classified as capital leases and variable interest entities for accounting purposes are disclosed in note 7 "Long-Term Debt and Capital Lease Obligations".

The future minimum non-cancellable commitments under the capacity purchase agreements with unaffiliated regional carriers are $10 in 2006.

17. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Under its risk management policy, the Corporation manages its exposure to changes in interest rates, foreign exchange rates and jet fuel prices through the use of various derivative financial instruments. The Corporation uses derivative financial instruments only for risk management purposes, not for generating trading profit.

INTEREST RATE RISK MANAGEMENT

The Corporation enters into forward interest rate agreements, with maturities of less than 18 months, to manage the risks associated with interest rate movement on US and Canadian floating rate debt and investments. During 2005, the Corporation reached a settlement with a third party related to interest rate swaps that were terminated as a result of Air Canada's filing for CCAA on April 1, 2003. A dispute had arisen following termination between Air Canada and the unrelated third party with respect to replacement arrangements for the swaps. The settlement agreement provided for a payment to Air Canada of US$8 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 in favour of the Corporation on inception. As a result of these transactions, the Corporation recorded a gain of $17 net of transaction fees of $3. The swaps have a term to January, 2024 and convert lease payments related to two B767 aircraft leases consolidated under AcG-15, from fixed to floating rates. These have not been designated as hedges for accounting purposes. As at December 31, 2005, these two swaps have a fair value of $7 in favour of the Corporation.

FOREIGN EXCHANGE RISK MANAGEMENT

The Corporation enters into certain foreign exchange forward contracts or currency swaps to manage the risks associated with foreign currency exchange rates. As at December 31, 2005, the Company had entered into foreign currency forward contracts and option agreements on US$521 of future purchases in 2006. The fair value of these foreign currency contracts as at December 31, 2005 is $1 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. The Corporation had no foreign exchange forward contracts outstanding as at December 31, 2004.

The Corporation has entered into currency swap agreements for 16 Canadair Regional Jet (CRJ) operating leases until lease terminations between 2007 and 2011. Currency swaps for five CRJ operating leases, with third parties, were put in place on the inception of the leases and have a fair value at December 31, 2005 of $13 in favour of the third parties (2004 $12 in favour of third parties), taking into account foreign exchange rates in effect at that time. Currency swaps for 11 CRJ operating leases with third parties, have a fair value at December 31, 2005 of $3 in favour of the Corporation. These have not been designated as hedges for hedge accounting purposes. The unrealized changes in fair value have been recorded in foreign exchange gain or loss.

FUEL PRICE RISK MANAGEMENT

The Corporation enters into contracts with financial intermediaries to manage its exposure to jet fuel price volatility. The Corporation had no fuel hedging agreements outstanding as at December 31, 2004. As of December 31, 2005, the Corporation had collar option structures in place to hedge a portion of its anticipated jet fuel requirements over the 2006 to 2007 period. Since 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 uses these commodities for medium to longer term hedges. As of December 31, 2005, the majority of the Company's first quarter 2006 hedges are effectively jet fuel-based contracts. For 2006, the majority of the remainder of the Corporation's hedge positions are effectively in the form of heating oil-based contracts. The majority of the remaining hedge positions are crude oil-based contracts. Hedge accounting was applied prospectively from October 1, 2005. Under hedge accounting, gains or losses on fuel hedging contracts are recognized in earnings as a component of aircraft fuel expense when the underlying jet fuel being hedged is consumed. Prior to these derivative instruments being designated as hedges for accounting purposes, an unrealized gain of $2 was recorded in other non-operating expense. The Corporation recognized a net loss of $3 as a component of fuel expense on the consolidated statement of operations. The fair value of the Company's fuel hedging agreements at December 31, 2005 was $3 in favour of third parties.

CONCENTRATION OF CREDIT RISK

The Corporation does not believe it is subject to any significant concentration of credit risk. Cash and short-term investments are in place with major financial institutions, Canadian governments and major corporations. Accounts receivable are generally the result of sales of tickets to individuals through geographically dispersed travel agents, corporate outlets, or other airlines, often through the use of major credit cards.

STATEMENT OF FINANCIAL POSITION FINANCIAL INSTRUMENTS - FAIR VALUES

The carrying amounts reported in the consolidated statement of financial position for cash and short-term investments, accounts receivable and accounts payable approximate fair values due to the immediate or short-term maturities of these financial instruments.

The fair value of the investment in US Airways is $217 as at December 31, 2005 compared with a carrying value of $87. The fair value of long-term debt and capital lease obligations as at December 31, 2005 approximates its carrying value.

18. CONTINGENCIES, GUARANTEES AND INDEMNITIES

CONTINGENCIES

WestJet

Air Canada as well as Zip Air Inc. (a subsidiary of Air Canada) filed an action in the Ontario Superior Court against WestJet Airlines Ltd. ("WestJet") and seven of its current and former employees (the "Air Canada Action") arising out of their misuse of Air Canada's confidential information relating to flights and load factors from an internal web site. Air Canada successfully sought an injunction prohibiting WestJet from making further use of the confidential information. The claim seeks an order requiring WestJet to disgorge incremental revenue and profits arising from the misuse of such confidential information, damages for spoliation and punitive damages aggregating in excess of $220. WestJet and Mark Hill, founding member and former Vice President of Strategic Planning for WestJet, have each counterclaimed against Air Canada, Zip Air Inc. (the "WestJet Counterclaims"), IPSA (security firm engaged by Air Canada) and two of the latter's employees alleging trespass and illegal access and use of confidential information of WestJet and Mark Hill. The WestJet Counterclaims are for $10 plus certain other unquantified damages. In addition, WestJet filed a separate lawsuit against Air Canada, Zip Air Inc., and certain of their present and former officers (the "WestJet Action") alleging abuse of process, tortious litigation and conspiracy to injure WestJet. The amount claimed in the WestJet Action is $30 plus other unquantified damages.

By Order dated May 25, 2005, upon a motion to dismiss filed by Air Canada and Zip Air Inc. the Honourable Justice Nordheimer of the Ontario Superior Court of Justice dismissed the WestJet Action. An appeal of this decision is pending. The Air Canada Action and the WestJet Counterclaims are still at a preliminary stage. Document production is ongoing and examinations on discovery have been set to start in May 2006.

It is the opinion of Management that the claims and counterclaims of WestJet and Mark Hill are without merit and further that the resolution of these lawsuits will not have a material adverse effect on the Corporation's consolidated financial position. The outcome of these claims and counterclaims cannot be determined at this point and the financial statements do not include any amounts related to these claims or counterclaims.

Pay Equity

Complaints filed in 1991 and 1992 with the Canadian Human Rights Commission against Air Canada and the former Canadian Airlines International on behalf of flight attendants at the two airlines alleging discrimination in negotiated wages were referred to the Canadian Human Rights Tribunal in 1996 for inquiry. By agreement of all parties, the inquiry before the Tribunal was limited to whether flight attendants at each airline were in the same establishment as pilots and technical operations personnel. Under the applicable legislation, a complaint can only compare the value of employees work and their wages if they work in the same establishment. In December 1998 the Tribunal found that pilots, flight attendants and technical operations personnel were in different establishments at each airline. This decision was upheld on judicial review by the Federal Court Trial Division, but overturned by the Federal Court of Appeal in 2004. The Supreme Court of Canada in January 2006 dismissed Air Canada's appeal from this latter decision and has remitted the complaints to the Commission for investigation. The value of each employee group's work will be assessed on the basis of the skill, effort and responsibility it demands as well as the conditions under which it is performed. During the restructuring under CCAA, it was agreed that any resolution of the complaints would have no retroactive financial impact prior to September 30, 2004.

Air Canada, upon consultation with legal counsel, considers that any investigation will show that it is complying with the equal pay provisions of the Canadian Human Rights Act.

Other

Various other lawsuits and claims, including claims filed by various of the Company's labour groups, are pending by and against the Corporation and provisions have been recorded where appropriate. It is the opinion of management that final determination of these claims will not have a significant material adverse effect on the financial position or the results of the Corporation.

Claims against the Predecessor Company, whether filed or unfiled, for events that occurred before April 1, 2003 and in certain cases up to September 30, 2004 (as described in note 19) have been compromised and discharged pursuant to the CCAA Plan and Sanction Order.

GUARANTEES

Residual Value Guarantees in Aircraft Leasing Agreements

With respect to 35 GECC owned aircraft leases and 10 GECC managed aircraft leases (refer to note 19), the difference between the amended rents from the restructuring arrangements and amounts due under the original lease contracts will be forgiven at the expiry date of the leases if no material defaults have occurred. If a material default occurs, this difference plus interest will become due and payable and all future rent will be based on the original contracted rates. Rent expense is being recorded on the renegotiated lease agreements and any liability would be recorded only at the time management believes the amount is likely to occur.

Guarantees in Fuel Facilities Arrangements

The Corporation participates in fuel facilities arrangements, along with other airlines that contract for fuel services at various airports in Canada. The Fuel Facilities Corporations operate on a cost recovery basis. The purpose of the Fuel Facilities Corporations is to own and finance the system that distributes the fuel to the contracting airlines, including leasing the Land Rights under the land lease. The aggregate debt of the five Fuel Facilities Corporations in Canada that have not been consolidated by the Corporation under AcG-15 is approximately $87 as at December 31, 2005, 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. Each Contracting Airline shares pro rata, based on system usage, in the guarantee of this debt.

Under the terms of its land leases, the Fuel Facilities Corporations have an obligation to restore the land to vacant condition at the end of the lease and to rectify any environmental damage for which it is 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, the Corporation has recorded an obligation of $2 ($12 undiscounted) representing the present value of the estimated decommissioning and remediation obligations at the end of the lease, with lease term expiry dates ranging from 2032 to 2039. This estimate is based on numerous assumptions including the overall cost of decommissioning and remediation and the selection of alternative decommissioning and remediation approaches.

INDEMNIFICATION AGREEMENTS

The Corporation enters into real estate leases or operating agreements, which grant a license to the Corporation to use certain premises, in substantially all cities that it serves. It is common in such commercial lease transactions for the Corporation as the lessee to agree to indemnify the lessor and other related third parties for tort liabilities that arise out of or relate to the Corporation's use or occupancy of the leased or licensed premises. Exceptionally, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but usually excludes any liabilities caused by their gross negligence or wilful misconduct. Additionally, the Corporation typically indemnifies such parties for any environmental liability that arises out of or relates to its use or occupancy of the leased or licensed premises.

In aircraft financing or leasing agreements, the Corporation typically indemnifies the financing parties, trustees acting on their behalf and other related parties and/or lessors against liabilities that arise from the manufacture, design, ownership, financing, use, operation and maintenance of the aircraft and for tort liability, whether or not these liabilities arise out of or relate to the negligence of these indemnified parties, except for their gross negligence or wilful misconduct. In addition, in aircraft financing or leasing transactions, including those structured as leveraged leases, the Corporation typically provides indemnities in respect of certain tax consequences.

In technical service agreements entered into with certain types, and a limited number, of customers, such as financing parties (typically aircraft lessors that require technical services prior to leasing the aircraft), the Corporation exceptionally indemnifies the customer, usually up to an agreed-upon indemnity threshold, against liabilities that arise from the Corporation's negligence.

When the Corporation, as a customer, enters into technical service agreements with service providers, primarily service providers who operate an airline as their main business, the Corporation has from time to time agreed to indemnify the service provider against liabilities that arise from third party claims, whether or not these liabilities arise out of or relate to the negligence of the service provider, but excluding liabilities that arise from the service provider's gross negligence or wilful misconduct.

Under its general by-laws, the Corporation has indemnification obligations to its directors and officers. Pursuant to such obligations, the Corporation indemnifies these individuals, to the extent permitted by law, against any and all claims or losses (including amounts paid in settlement of claims) incurred as a result of their service to the Corporation.

The maximum amount payable under the foregoing indemnities cannot be reasonably estimated. The Corporation expects that it would be covered by insurance for most tort liabilities and certain related contractual indemnities described above.

19. THE PLAN AND OTHER RESTRUCTURING ARRANGEMENTS

THE PLAN

On April 1, 2003, Air Canada obtained an order from the Ontario Superior Court of Justice (the "Court") providing creditor protection under CCAA. On April 1, 2003, Air Canada, through its Court-appointed Monitor, also made a concurrent petition for recognition and ancillary relief under Section 304 of the U.S. Bankruptcy Code. The CCAA and US proceedings covered Air Canada and the following of its wholly-owned subsidiaries: Jazz Air Inc., Zip Air Inc., 3838722 Canada Inc., Air Canada Capital Ltd., Manoir International Finance Inc., Simco Leasing Ltd., and Wingco Leasing Inc. (collectively, the "Applicants"). Air Canada Vacations, Aeroplan, Maple Leaf Holdings USA Inc. and Destina.ca Inc. were not included in the filings. During the proceedings, the Applicants continued to operate under Court protection.

On August 17, 2004, the creditors approved the Plan and on August 23, 2004, the Plan was confirmed pursuant to an order of the Court. The Plan was implemented through a series of steps which were completed on September 30, 2004 (except as to the winding up of Zip which occurred on October 1, 2004). Accordingly, on September 30, 2004, the Applicants emerged from CCAA and ACE became the parent company of Air Canada and its subsidiaries.

The confirmed Plan provided for the following:

- A corporate reorganization of Air Canada and its subsidiaries into separate business units resulting in the following operating subsidiaries of ACE: Air Canada, Air Canada Cargo, Air Canada Groundhandling, Air Canada Vacations, Destina.ca Inc., AC Online Limited Partnership, Aeroplan, Jazz, and ACTS.

- The affected unsecured creditors' claims were settled, compromised and released in exchange for 46,250,000 shares in ACE and rights to acquire further shares pursuant to a rights offering (the "Rights Offering"). Additional information on the share capital of ACE is described in note 12. In accordance with the Plan, shares were held in escrow pending resolution of disputed unsecured claims. Once claims were resolved, the disbursing agent distributed the shares in accordance with the provisions of the Plan with the exception of 27,927 shares that continue to be held in escrow by the Monitor pending resolution of tax obligations with governmental obligations. None of these shares held in escrow will return to ACE or any of its subsidiaries.

- All issued and outstanding options of Air Canada, including the conversion feature in the convertible subordinated debentures, and warrants were cancelled without payment or consideration.

- Holders of Air Canada's Class A non-voting common shares received a nominal number of ACE Class A Variable Voting Shares and holders of Air Canada's common shares received a nominal number of ACE Class B Voting Shares representing approximately 0.01% of the fully diluted equity of ACE. In total, 10,104 shares were issued to the holders of Air Canada's common shares.

- Air Canada's Class A Convertible Participating Non-Voting Convertible Preferred Shares (Series 1) were converted into Air Canada Redeemable Shares which were redeemed for an aggregate consideration of one dollar.

- A comprehensive release in favour of the Applicants of all claims of Affected Unsecured Creditors based upon any matters up until September 30, 2004 other than certain categories of excluded claims (including affirmed contracts and claims arising from the supply of goods and services after the date of filing) as specified in the Plan and Sanction Order.

GLOBAL RESTRUCTURING AGREEMENT

All transactions contemplated by the Global Restructuring Agreement ("GRA") with General Electric Capital Corporation and its affiliates ("GECC") became effective on September 30, 2004.

Under the GRA, leases related to 106 operating, parked and undelivered aircraft were restructured resulting in a reduction of lease rates for 47 aircraft, termination of obligations for 20 parked aircraft, the cancellation of four future aircraft lease commitments and the restructuring of the overall obligations with respect to six aircraft.

Prior to filing for CCAA on April 1, 2003, the Predecessor Company had payment and purchase obligations in respect of two B747 aircraft with GECC. As a condition of the GRA, on September 30, 2004, Air Canada acquired these two aircraft, with a fair market value of $63, from GECC for an aggregate amount of $353. GECC provided financing in the amount of US$50, of which US$25

was repaid during the three months ended December 31, 2004 upon the sale of one of the aircraft, and the remainder was repaid in January 2005 upon the sale of the second aircraft. The difference of $290 was paid to GECC on September 30, 2004, under the terms of the GRA. This one-time payment of $290 has been classified as a cash flow used for the operating activities of ACE.

GECC provided ACE with an Exit Facility in the amount of $540 before fees of $13. The terms and conditions of this Exit Facility are set out in note 7. Cash proceeds received under the Exit Facility were reduced by the amount drawn under the DIP Loan Agreement as at September 30, 2004 of $300. In addition, ACE provided cash collateralization of certain outstanding letters of credit totalling $21. This amount is recorded under other assets. The Corporation further paid an amount of $45 to GECC related to restructuring certain obligations with GECC. An amount of $37 has been allocated to certain ongoing lease arrangements and $8 to standby financing with GECC in the Corporation. As a result of this payment, the warrants as outlined in the GRA were not issued.

RIGHTS OFFERING AND STANDBY PURCHASE AGREEMENT

As part of the Plan, the affected unsecured creditors were entitled to subscribe for up to 42,500,000 ACE Class B Voting Shares and/or ACE Class A Variable Voting Shares or approximately 42.06% of the Fully Diluted Equity of ACE as of September 30, 2004 pursuant to the Rights Offering. In accordance with a Standby Purchase Agreement (the "Standby Purchase Agreement") entered into with Deutsche Bank Securities Inc. ("DB"), ACE completed the issuance of 42,500,000 shares under its rights offering for proceeds of $865 before fees of $13. DB and its participants acquired, as standby purchasers, 9,829,339 Class A Variable Voting Shares relating to unexercised rights.

INVESTMENT AGREEMENT

In accordance with an investment agreement (the "Investment Agreement") with Cerberus ACE Investment, LLC and Promontoria Holding III B.V., affiliates of Cerberus Capital Management L.P. (collectively, "Cerberus"), ACE issued 12,500,000 Convertible Preferred Shares for an aggregate consideration of $250 before expenses of $12. See note 12 for further details related to the Convertible Preferred Shares.

PENSION PLAN ARRANGEMENTS

On September 30, 2004, with the agreement of the Office of the Superintendent of Financial Institutions, Air Canada issued a series of subordinated security promissory notes in the aggregate amount of approximately $347 in favour of the pension plan trustee. See note 9 for further details on these notes.

20. FRESH START REPORTING

ACE applied fresh start reporting on September 30, 2004. As a result, all consolidated assets and liabilities of the Corporation have been reported at fair values, except for future income taxes which are reported in accordance with the requirements of Section 3465 of the CICA Handbook, Income Taxes. As a result of the implementation of the Plan and the application of fresh start reporting, a revaluation adjustment of $3,342 has been recorded as a credit to the Predecessor's Shareholders' Equity and the deficit and contributed surplus of Air Canada as at September 30, 2004 has been reclassified to the Predecessor's Shareholders' Equity. The resulting deficit of $2,700, net of contributed surplus of $175 was reclassified to the Predecessor's share capital and other equity. The fair values of the consolidated assets and liabilities of the Corporation have been based on Management's best estimates and on valuation techniques as of September 30, 2004. As the result of the application of fresh start accounting (whereby the liabilities of the Corporation exceed the total assets of the Corporation excluding any implied goodwill) and the financing transactions that occurred on September 30, 2004, the Corporation's Shareholders' Equity was $186.

	Air Canada Predecessor Company Sept 30, 2004	Plan of Arrangement [a]	Fresh Start Reporting [f]	Equity and Other Financing Transactions	ACE Successor Company Sept 30, 2004
ASSETS					
Current assets					
Cash and cash equivalents	$ 957	$ -	$ -	$ 227[b]	$ 1,939
				852[c]	
				238[d]	
				(335)[e]	
Restricted cash	62	-	-	-	62
Accounts receivable	723	-	-	-	723
Spare parts, materials and supplies	190	-	11	-	201
Prepaid expenses	129	-	10	-	139
	2,061	-	21	982	3,064
Property and equipment	3,749	-	(149)	64	3,664
Deferred charges	3,175	-	(3,033)	19	161
Goodwill	510	-	(510)	-	-
Intangible assets	158	-	2,561	-	2,719
Other assets	443	-	(343)	-	100
TOTAL ASSETS	$ 10,096	$ -	$ (1,453)	$ 1,065	$ 9,708
LIABILITIES					
Liabilities not subject to compromise					
Current liabilities					
Accounts payable and accrued liabilities	$ 1,199	$ -	$ 112	$ -	$ 1,311
Advance ticket sales and loyalty program deferred revenues	861	-	268	-	1,129
Current portion of long-term debt and capital lease obligations	558	-	(319)	-	239
	2,618	-	61	-	2,679
Long-term debt and capital lease obligations	1,425	-	789	303	2,517
Convertible preferred shares	-	-	-	127	127
Future income taxes [h]	8	-	235	-	243
Pension and other benefit liabilities [g]	1,072	-	1,296	-	2,368
Other long-term liabilities	1,284	-	304	-	1,588
Deferred credits	758	-	(424)	(334)	-
	7,165	-	2,261	96	9,522
Liabilities subject to compromise [i]	7,981	(7,981)	-	-	-
	15,146	(7,981)	2,261	96	9,522
SHAREHOLDERS' EQUITY					
Share capital and other equity	967	925	(2,525)	852	186
		(125)		117	
		(25)	-		
Contributed surplus	25	150	(175)	-	-
Deficit	(6,042)	7,056	(1,014)	-	-
	(5,050)	7,981	(3,714)	969	186
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 10,096	$ -	$ (1,453)	$ 1,065	$ 9,708

The following legend describes the adjustments made to the Predecessor accounts resulting from the implementation of the Plan and consummation of the various agreements described in note 19:

(a) Implementation of the Plan.

(b) Implementation of the Exit Facility under the GRA.

(c) Issuance of shares for cash under the Rights Offering and the Standby Purchase Agreement.

(d) Issuance of Convertible Preferred Shares for cash under the Investment Agreement.

(e) Implementation, under the GRA, of the purchase of two B747 aircraft with GECC and the payment of $45 to GECC related to restructuring certain obligations with GECC.

(f) Comprehensive revaluation of assets and liabilities.

(g) The effect of the issuance of the subordinated security promissory notes described in note 9 is also included within the fair value of the obligation for pension benefits as at September 30, 2004.

(h) Future income taxes have been adjusted to reflect the tax effects of differences between the fair value of identifiable assets and liabilities and their estimated tax bases and the benefits of any unused tax losses and other deductions to the extent that these amounts are more likely than not to be realized. The resulting future income tax amounts have been measured based on the rates substantively enacted that are expected to apply when the temporary differences reverse or the unused tax losses and other deductions are realized. It has been assumed that certain intangibles with a fair value as at the date of fresh start reporting of approximately $1,431, with no underlying tax cost, have indefinite lives and accordingly, the associated future income tax liability of $243 is not expected to reverse until the intangible assets are disposed of or become amortizable.

(i) Liabilities subject to compromise as accrued by the Applicants totalled $7,981. Differences from the minimum potential claims of $8,205 as reported by the Monitor arise primarily from the difference in foreign exchange rates as at April 1, 2003, the rates used in the claims resolution process, and the current rates as at September 30, 2004.

21. REORGANIZATION AND RESTRUCTURING ITEMS

Cash expenditures related to reorganization and restructuring items for the nine months ended September 30, 2004 amounted to $85 and relate mainly to the payment of professional fees. Reorganization and restructuring items are nil in 2005 as no charges have been recorded in the Corporation. The table below summarizes reorganization and restructuring charges recorded by the Predecessor Company.

	Predecessor Company Nine Months Ended Sept 30, 2004
Repudiated and renegotiated leases and contracts [a]	$ 529
Labour related items [b]	279
Foreign exchange adjustments on compromised debt	(84)
Professional fees	158
Interest income on accumulated cash [c]	(17)
Other	6
Reorganization and restructuring items, net	**$ 871**

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

(b) Labour related items of $279 during the nine months ended September 30, 2004 include voluntary and involuntary severance programs accruals of $117 as well as $162 of amortization on the estimated compromised claim related to the Predecessor Company's employee groups. Refer to note 10 Other long-term liabilities for additional information on these and other labour related restructuring provisions.

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

22. CONDENSED COMBINED FINANCIAL STATEMENTS

Consolidated financial statements of an entity under creditor protection that include one or more entities in reorganization proceedings and one or more entities not in reorganization proceedings should include disclosure of condensed combined financial statements of the entities in reorganization proceedings. The following are the condensed combined Statement of Operations and Statement of Cash Flow of the entities of the Predecessor Company that were in CCAA for the nine months ended September 30, 2004. Included in the Statement of Operations for the nine months ended September 30, 2004 are intercompany revenues of $301 and expenses of $184 with non-Applicants.

Condensed Combined Statement of Operations	Predecessor Company Nine Months Ended Sept 30, 2004
Operating revenues	$ 6,581
Operating expenses	6,596
Operating loss before reorganization and restructuring items	**(15)**
Reorganization and restructuring items (note 21)	(871)
Net interest expense	(171)
Loss on sale of assets	(74)
Other non-operating income, including equity income of non-applicants	129
Loss before foreign exchange on non-compromised long-term monetary items and income taxes	**(1,002)**
Foreign exchange on non-compromised long-term monetary items	107
Loss before income taxes	**(895)**
Provision for income taxes	-
Loss for the period	**$ (895)**

Condensed Combined Statement of Cash Flow	Predecessor Company Nine Months Ended Sept 30, 2004
Net cash provided by operating activities	$ 320
Financing	
Aircraft related borrowings	233
Reduction of long-term debt and capital lease obligations	(358)
Drawdown on GE DIP financing	300
Credit facility borrowings	80
	255
Investing	
Additions to property and equipment	(320)
Proceeds from sale of assets	1
	(319)
Increase in cash and cash equivalents	256
Cash and cash equivalents, beginning of period	697
Cash and cash equivalents, end of period	**$ 953**

23. ACE AVIATION HOLDINGS INC. / AIR CANADA DIFFERENCES BETWEEN GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN CANADA AND THE UNITED STATES

(Canadian dollars – millions except per share data)

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

As outlined in notes 1, 2, 19 and 20, Air Canada emerged from creditor protection on September 30, 2004 and became a subsidiary of ACE Aviation Holdings Inc.

	Successor Company		Predecessor Company
	Year Ended Dec 31, 2005	Period Ended Dec 31, 2004	Nine Months Ended Sept 30, 2004
Income (loss) for the period in accordance with Canadian GAAP	$ 258	$ 15	$ (895)
Aircraft introduction costs (1)	-	-	5
Derivative instruments (2)	(11)	-	(32)
Residual value guarantee adjustment (3)	-	-	14
Pension valuation allowance (4)	-	-	(6)
Pre-operating costs (5)	-	-	6
Convertible securities (6)	41	(99)	-
Variable interest entity adjustment (7)	-	35	11
Amortization of intangible assets (8)	(3)	-	-
Goodwill impairment (8)	(12)	-	-
Aeroplan dilution gain reduction (8)	(82)	-	-
Gain on discharge of compromised liabilities (12)	-	-	7,056
Fresh start reporting (12)	-	-	(1,501)
Income adjustments for the period before the following	**(67)**	**(64)**	**5,553**
Cumulative effect of change in accounting policy - Variable interest entity adjustment (7)	-	-	(178)
Income tax adjustment (8)	19	(2)	-
Non-controlling interest - Variable interest entity adjustment (7)	-	(2)	(5)
Respective period income adjustments	**(48)**	**(68)**	**5,370**
Income (loss) for the period in accordance with US GAAP	210	(53)	4,475
Minimum pension liability adjustment, net of tax of $82 (4)	(162)	(2)	(2)
Available-for-sale securities, net of tax of $22 (11)	108	-	-
Fresh start reporting (12)	-	-	491
Comprehensive income (loss) for the period in accordance with US GAAP	**$ 156**	**$ (55)**	**$ 4,964**
Earnings (loss) per share - US GAAP			
- Basic	**$ 1.94**	**$ (0.65)**	**$ 38.27**
- Diluted	**$ 1. 84**	**$ (0.65)**	**$ 33.05**

	Successor Company December 31, 2005		Successor Company December 31, 2004	
Property and equipment				
Balance under Canadian GAAP	$	5,494	$	3,684
Variable interest entity adjustment [7]		-		1,417
Balance under US GAAP	**$**	**5,494**	**$**	**5,101**
Deferred charges				
Balance under Canadian GAAP	$	145	$	167
Deferred finance charges [6]		(2)		(6)
Variable interest entity adjustment [7]		-		(15)
Balance under US GAAP	**$**	**143**	**$**	**146**
Goodwill				
Balance under Canadian GAAP	$	-	$	-
Goodwill [8]		1,452		1,583
Balance under US GAAP	**$**	**1,452**	**$**	**1,583**
Intangible Assets				
Balance under Canadian GAAP	$	2,462	$	2,703
Variable interest entity adjustment [7]		-		(39)
Goodwill [8]		146		11
Balance under US GAAP	**$**	**2,608**	**$**	**2,675**
Other assets				
Balance under Canadian GAAP	$	392	$	137
Derivative Instruments [2]		(11)		-
Variable interest entity adjustment [7]		-		111
Available for sale securities [11]		130		-
Balance under US GAAP	**$**	**511**	**$**	**248**
Current portion of long-term debt				
Balance under Canadian GAAP	$	265	$	218
Variable interest entity adjustment [7]		-		77
Balance under US GAAP	**$**	**265**	**$**	**295**
Long-term debt and capital lease obligations				
Balance under Canadian GAAP	$	3,543	$	2,328
Variable interest entity adjustment [7]		-		1,230
Convertible securities [6]		22		-
Balance under US GAAP	**$**	**3,565**	**$**	**3,558**
Convertible preferred shares				
Balance under Canadian GAAP	$	148	$	132
Reclassification of preferred shares [6]		(148)		(132)
Balance under US GAAP	**$**	**-**	**$**	**-**
Pension and other benefit liabilities				
Balance under Canadian GAAP	$	2,154	$	2,344
Minimum pension liability adjustment [4]		246		2
Balance under US GAAP	**$**	**2,400**	**$**	**2,346**

	Successor Company December 31, 2005	Successor Company December 31, 2004
Future income taxes		
Balance under Canadian GAAP	$ 221	$ 243
Goodwill [8]	22	-
Balance under US GAAP	**$ 243**	**$ 243**
Other long-term liabilities		
Balance under Canadian GAAP	$ 1,399	$ 1,520
Convertible preferred shares - embedded derivative [6]	165	180
Convertible notes - embedded derivative [6]	64	-
Variable interest entity adjustment [7]	-	(156)
Balance under US GAAP	**$ 1,628**	**$ 1,544**
Minority interest		
Balance under Canadian GAAP	$ 203	$ -
Variable interest entity adjustment [7]	-	178
Balance under US GAAP	**$ 203**	**$ 178**
Temporary equity		
Balance under Canadian GAAP	$ -	$ -
Reclassification of convertible preferred shares [6]	182	167
Balance under US GAAP	**$ 182**	**$ 167**
Shareholders' equity		
Balance under Canadian GAAP	$ 1,168	$ 203
Convertible securities [6]	(20)	(5)
Reclassification of convertible preferred shares and convertible notes [6]	(209)	(117)
Variable interest entity adjustment [7]	-	112
Goodwill recorded at fresh start [8]	1,596	1,596
Current year income adjustments	(48)	(68)
Current year adjustments for comprehensive income		
Minimum pension liability adjustment, net of tax of $82 [4]	(162)	(2)
Available for sale securities, net of tax of $22 [11]	108	-
Cumulative prior year adjustments for:		
Future income tax	(2)	-
Convertible securities	(99)	-
Comprehensive income		
Minimum pension liability adjustment [5]	(2)	-
Balance under US GAAP	**$ 2,330**	**$ 1,719**

Cash flows from (used for)	Successor Company Year Ended Dec 31, 2005	Successor Company Period Ended Dec 31, 2004	Predecessor Company Nine Months Ended Sept 30, 2004
Operating - Canadian GAAP	$ 675	$ (426)	$ 360
Addback: principal repayments on variable interest entities and lease accounting	-	10	59
Operating - US GAAP	**675**	**(416)**	**419**
Financing - Canadian GAAP	801	1,251	253
Less: principal repayments on variable interest entities and lease accounting	-	(10)	(59)
Financing - US GAAP	**801**	**1,241**	**194**
Investing	(1,392)	(301)	(140)
Increase (decrease) in cash and cash equivalents	**84**	**524**	**473**
Cash and cash equivalents, beginning of period	1,481	-	484
Cash and cash equivalents transferred to the Successor Company	-	957	(957)
Cash and cash equivalents, end of period	$ 1,565	$ 1,481	$ -

1. Aircraft Introduction Costs

Under Canadian GAAP, the Predecessor Company deferred and amortized aircraft introduction costs. Under US GAAP, these costs are expensed as incurred. The Corporation expenses aircraft introduction costs as incurred. Under Canadian GAAP, the Predecessor Company recorded amortization expense of $5 for the nine months ended September 30, 2004.

2. Derivative Financial Instruments

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

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

As described in note 2, under Canadian GAAP, derivatives under the fuel-hedging program are designated as hedges for accounting purposes and hedge accounting is being applied prospectively from October 1, 2005. Under hedge accounting, gains or losses on fuel hedging contracts are recognized in earnings as a component of aircraft fuel expense when the underlying jet fuel being hedged is used. The Corporation has elected not to designate any derivatives under the fuel-hedging program as hedging instruments for US GAAP purposes and as such, changes in the fair value of all derivative instruments are recorded in income. The adjustment of $11 reflects recording of the fair value of outstanding derivative contracts of $3 in favour of third parties and the write-off of the asset recorded under Canadian GAAP of $8.

3. Residual Value Guarantees under Operating Leased Aircraft

Under Canadian GAAP, the portion of the gain on sale-leasebacks that includes a residual value guarantee is deferred until the end of the lease term for leases entered into after September 1999, whereas under US GAAP, the amount would be deferred until the end of the lease term for leases entered into after September 1986. Further, under Canadian GAAP, the expected deficiency under a residual value guarantee is accrued over the remaining lease term irrespective of the end of lease term options for leases entered into after September 1999; however, under US GAAP, the accrual of an expected deficiency is required for leases entered into after September 1996. In the Corporation, all aircraft lease agreements with residual value guarantees are consolidated under the Variable Interest Entity adjustment described under note 2. The adjustment for the nine months ended September 30, 2004 relates to the amortization of the previous accrual of the residual value guarantee on renegotiated leases where the residual value guarantee has been removed.

4. Employee Future Benefits

Under Canadian GAAP, if the accumulated benefit obligation related to employee pensions exceeds the fair value of plan assets, a pension valuation allowance is required to limit the pension asset to the amount that can be realized in the future. A valuation allowance is not permitted under US GAAP. For defined benefit plans, US GAAP requires the unfunded accumulated benefit obligation to be recorded as additional minimum liability. The excess of the unfunded accumulated benefit obligation over the unrecognized prior service cost is recorded in other comprehensive income.

5. Pre-operating Costs

Under Canadian GAAP, eligible pre-operating costs are deferred and amortized. Under US GAAP, these costs are expensed as incurred. Under Canadian GAAP, the Predecessor Company recorded amortization expense of $6 for the nine months ended September 30, 2004. Under Canadian GAAP, all deferred pre-operating costs were eliminated upon the application of fresh start reporting. No amounts have been deferred under Canadian GAAP in ACE.

6. Convertible Securities

Preferred Shares

Under Canadian GAAP, as described in note 12, the convertible preferred shares issued in 2004 are presented as a compound instrument. At the date of issuance, the value ascribed to the holder's conversion option, which is presented in equity was $123 less allocated fees of $6; the value ascribed to the financial liability was $127. Under US GAAP, the convertible preferred shares contain an embedded derivative which has been reported separately as an other long-term liability at its fair value of $165 as at December 31, 2005 ($180 as at December 31, 2004). The convertible preferred shares were initially recorded at $162 which is the proceeds received less direct costs of issuance and the fair value of the embedded derivative, as of the date of issuance, and is included in temporary equity as the conditions of redemption are not solely within the control of the Corporation. The adjustment to deferred charges reflects applying the direct costs of issuance, recorded in deferred charges under Canadian GAAP, against the amount recorded in temporary equity.

For the convertible preferred shares, the changes in the fair value of the embedded derivative are included in income and the accretion of the temporary equity to the redemption value over the period to redemption is reflected as a charge to retained earnings. The change in the fair value of the embedded derivative includes the 5% accretion per annum on the convertible preferred shares.

The adjustment reflects the reversal of interest expense under Canadian GAAP of $17 (September 30, 2004 – nil; December 31, 2004 - $5); change in the fair values of the embedded derivative amounted to a decrease of $15 (2004 – increase of $104 in the Corporation, Predecessor – nil); and the amount charged to retained earnings under US GAAP of $20 (2004 - $5 in the Corporation, Predecessor – nil).

Convertible Notes

Under Canadian GAAP, as described in note 7, the convertible notes issued in April 2005 are presented as a compound instrument. At the date of issuance, the value ascribed to the holders' conversion option, which is presented as equity, was $94 less allocated fees of $2; the value ascribed to the financial liability was $236. Under US GAAP the convertible notes were initially recorded at $260 which is the proceeds received before costs of issuance and the fair value of the embedded derivative, as of the date of issuance, of $71. The direct costs of issuance of $11 are recorded in deferred charges. The adjustment also reflects the decrease to the liability related to the fair value of the embedded derivative amounting to $7 and a reduction to interest expense of $2.

7. Variable Interest Entities

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

The adjustment for the period ended December 31, 2004 of $33, reflects depreciation expense of $24, interest expense of $24, a foreign exchange gain of $53 and a non-controlling interest charge of $2 offset by the reversal of aircraft rent expense of $30. The adjustment for the nine months ended September 30, 2004 of $6, reflects depreciation expense of $73, interest expense of $80, a foreign exchange gain of $30 and a non-controlling interest charge of $5 offset by the reversal of aircraft rent expense of $134.

Upon the application of fresh start reporting, the assets and liabilities of the VIEs consolidated by the Corporation were adjusted to fair value, resulting in certain differences between the amounts reported by the VIE and the amounts reported in the consolidated statement of financial position.

8. Fresh Start Reporting and Goodwill

Under Canadian GAAP, the effects of the fresh start reporting adjustments, including the settlement of the compromised debt, are accounted for as a capital transaction and recorded within shareholders' equity. Under US GAAP, the effect of the fresh start reporting adjustments, including the settlement of the compromised debt, are reflected in the statement of operations.

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

Under Canadian GAAP, the benefit of future income tax assets that exist at fresh start, and for which a valuation allowance is recorded against, will be recognized first to reduce to nil any remaining intangible assets (on a pro-rata basis) that were recorded upon fresh start reporting with any remaining amount as a credit to shareholders' equity. Under US GAAP the benefit of future income tax assets that exist at fresh start will be recognized first to reduce to nil any goodwill, then intangibles with any remaining amount taken to income.

The adjustment for 2005 includes:

- a cumulative increase to intangible assets of $149, less amortization expense of $3;
- an increase to future income tax liabilities of $22;
- a cumulative reduction to goodwill of $144, including a goodwill impairment loss of $12 recorded during 2005 related to goodwill recorded in a reporting unit within the Transportation Services segment, and an Aeroplan dilution gain adjustment of $82 and tax adjustment of $22 as described further below;
- a reduction of future income tax expense of $19;
- a decrease to tax expense recorded in Other Comprehensive Income of $60; and
- a cumulative retained earnings adjustment of $(2).

For the period ended December 31, 2004, the Corporation recorded an increase of $11 to intangibles, a reduction of $13 to goodwill and a tax expense of $2.

As described in note 13, under Canadian GAAP, ACE has recorded a dilution gain of $190 as a result of the dilution of its interest in Aeroplan LP. Under US GAAP, the dilution gain is reduced by $82 as a result of the 14.4% disposal of the goodwill that was allocated to the Predecessor LP at fresh start reporting. In addition, the future income tax expense of $28 as reported under Canadian GAAP is reduced by $22 to $6 as a result of the disposal of goodwill. For US GAAP purposes the dilution gain of $108 less tax of $6 is classified as an extraordinary gain. Under US GAAP the calculation of earnings per share is disclosed before extraordinary gains.

9. Comprehensive Income

Under US GAAP, comprehensive income must be reported which is defined as all changes in equity other than those resulting from investments by owners and distributions to owners. Cumulative other comprehensive loss as at December 31, 2005 is $116 less net tax of $60 ($2 at December 31, 2004). For the periods presented, under Canadian GAAP, the Predecessor and the Corporation were not permitted to use the concept of comprehensive income. The adjustments to cumulative other comprehensive income relate mainly to the minimum pension liability adjustment described under item 4 and unrealized gains/losses on available for sale securities described under item 10.

10. Available-for-sale Securities

Under Canadian GAAP, portfolio investments are accounted for using the cost method. Under US GAAP, portfolio investments classified as available-for-sale securities are carried at market value with unrealized gains or losses reflected as a separate component of shareholders' equity and included in comprehensive income. Under US GAAP, an unrealized gain of $130 less tax of $22 has been recorded as a separate component of shareholders' equity and included in comprehensive income, to reflect the fair value of the US Airways investment of $217 at December 31, 2005.

11. Earnings per share

	Successor Company		Predecessor Company
	Year Ended Dec 31, 2005	Period Ended Dec 31, 2004	Nine Months Ended Sept 30, 2004
Numerator:			
Numerator for basic earnings per share:			
Income (loss)	$210	$(53)	$4,475
Accretion of convertible preferred shares	(20)	(5)	-
Settlement of convertible debentures	-	-	125
Adjusted numerator for income (loss) per share	**190**	**(58)**	**4,600**
Effect of potential dilutive securities:			
After tax income from:			
Convertible preferred shares	11	3	-
Convertible notes	15	-	-
Convertible subordinated debentures	-	-	-
Add back anti-dilutive impact	(15)	(3)	-
Adjusted income (loss) for diluted earnings per share	**$ 201**	**$ (58)**	**$ 4,600**
Denominator:			
Denominator for basic earnings per share:			
Weighted-average shares	98	89	120
Effect of potential dilutive securities:			
Stock options	1	1	-
Convertible preferred shares	10	9	-
Convertible notes	5	-	-
Class A non-voting preferred shares	-	-	10
Convertible subordinated debentures	-	-	9
	16	**10**	**19**
Add back anti-dilutive impact	(5)	(10)	-
Denominator for diluted earnings per share:			
Adjusted weighted-average shares	109	89	139
Basic earnings (loss) per share	**$ 1.94**	**$ (0.65)**	**$ 38.27**
Diluted earnings (loss) per share	**$ 1.84**	**$ (0.65)**	**$ 33.05**
Income (loss) per share before extraordinary item [8] and cumulative effect of change in accounting principle	$ 0.90	$ (0.65)	$ 39.75
Impact of:			
Extraordinary item [8]	1.04	-	-
Cumulative effect of change in accounting principle	-	-	(1.48)
Income (loss) per share	**$ 1.94**	**$ (0.65)**	**$ 38.27**
Income (loss) per share, assuming dilution, before extraordinary item [8] and cumulative effect of change in accounting principle	$ 0.88	$ (0.65)	$ 34.32
Impact of:			
Extraordinary item [8]	0.96	-	-
Cumulative effect of change in accounting principle	-	-	(1.28)
Income (loss) per share, assuming dilution	**$ 1.84**	**$ (0.65)**	**$ 33.05**

12. Supplementary Information under US GAAP

In the opinion of Management, the consolidated financial statements prepared in accordance with Canadian GAAP and the US GAAP information included in this note reflect adjustments, consisting of normal recurring accruals, except for adjustments referred to above under FIN 46R – Consolidation of Variable Interest Entities and Fresh Start Reporting, which are necessary to present fairly the Corporation and Predecessor Company's financial position, results of operations and cash flows for the periods indicated.

Fresh start reporting

Note 20 describes the impact of fresh start reporting under Canadian GAAP.

For US GAAP, it was determined that the Corporation's reorganization value was $11,753 as at September 30, 2004. The reorganization value represents the fair value of the entity before considering liabilities and approximates the amount a willing buyer would pay for the assets of the entity immediately after the plan of arrangement. The reorganization value does not include proceeds received from new investors outlined in note 19. The reorganization value was determined with reference to the value established under the Rights Offering.

The fair values of the consolidated assets and liabilities of the Corporation have been based on Management's best estimates and on valuation techniques as of September 30, 2004.

The effect of the Plan and other transactions on the Predecessor Company's consolidated balance sheet, as of September 30, 2004, is outlined in the table below and consists of the following components:

Plan of Arrangement:

- Extinguishment of compromised liabilities of approximately $7,981 by the issuance of common shares of the Corporation with a value of $925, resulting in a gain on extinguishment of debt in the amount $7,056 included in the statement of operations under US GAAP.

- Certain preferred shares with a carrying value of $125 were settled for a nominal amount resulting in a gain of $125 included as a credit to deficit.

- Exchange of the existing common shares of the Predecessor for new common stock of the Corporation resulting in a reduction of common stock by $817 and an increase in contributed surplus by $817.

Financing and Other Post-Emergence Transactions:

- The Rights Offering and Standby Purchase Agreement generated net proceeds of $852 in exchange for share capital. The Investment Agreement, as described in note 19, provided net cash proceeds of $238. As the convertible preferred shares include an embedded derivative, $76 was included in liabilities and $162 in temporary equity. Additional funds were received under the Exit Facility as described in note 19 under the Global Restructuring Agreement providing cash of $227, net of costs of $13. Implementation of components of the Global Restructuring Agreement (other than the Exit Financing) resulting in a net cash outlay of $323, issuance of additional debt amounting to $63, acquisition of aircraft for $64 and settlement of certain obligations related to leases totalling $334. In addition, fees to the Corporation's advisors of $12 were paid on emergence.

Fresh Start Reporting:

- Fresh start adjustments were recorded to reflect the fair values of assets and liabilities and the elimination of the contributed surplus and deficit. In the Predecessor Company, fresh start reporting resulted in a loss of $1,501 reported in income and a gain of $491 reported in comprehensive income.

	Air Canada Predecessor Company Sept 30, 2004	Plan of Arrangement	Fresh Start Reporting	Equity and Other Financing Transactions	ACE Successor Company Sept 30, 2004
ASSETS					
Current assets					
Cash and cash equivalents	$ 957	$ -	$ -	227	$ 1,939
				852	
				238	
				(335)	
Restricted cash	62	-	-	-	62
Accounts receivable	723	-	-	-	723
Spare parts, materials and supplies	190	-	11	-	201
Prepaid expenses	129	-	10	-	139
	2,061	-	21	982	3,064
Property and equipment	5,497	-	(456)	64	5,105
Deferred charges	2,661	-	(2,526)	13	148
Goodwill	220	-	1,376	-	1,596
Intangible assets	158	-	2,521	-	2,679
Other assets	1,166	-	(946)	-	220
TOTAL ASSETS	$ 11,763	$ -	$ (10)	$ 1,059	$ 12,812
LIABILITIES					
Liabilities not subject to compromise					
Current liabilities					
Accounts payable and accrued liabilities	$ 1,288	$ -	$ 23	$ -	$ 1,311
Advance ticket sales and loyalty program deferred revenues	861	-	268	-	1,129
Current portion of long-term debt and capital lease obligations	558	-	(230)	-	328
	2,707	-	61	-	2,768
Long-term debt and capital lease obligations	2,777	-	726	303	3,806
Future income taxes	8	-	235	-	243
Pension and other benefit liabilities	2,036	-	332	-	2,368
Other long-term liabilities	1,192	-	245	76	1,513
Minority Interest	344	-	(169)	-	175
Deferred credits	764	-	(430)	(334)	-
	9,828	-	1,000	45	10,873
Liabilities subject to compromise	7,981	(7,981)	-	-	-
	17,809	(7,981)	1,000	45	10,873
Temporary Equity	125	(125)	-	162	162
SHAREHOLDERS' EQUITY					
Share capital and other equity	817	925	(792)	852	1,777
		(25)			
Contributed surplus	25	150	(175)	-	-
Deficit	(6,522)	7,056	(534)	-	-
Other Comprehensive Loss	(491)		491	-	-
	(6,171)	8,106	(1,010)	852	1,777
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 11,763	$ -	$ (10)	$ 1,059	$ 12,812

Accounts payable and accrued liabilities

The components of accounts payable and accrued liabilities at December 31 are as follows:

	2005	2004
Trade payables	$ 356	$ 408
Accrued liabilities	192	224
Payroll related liabilities	508	404
Other	299	161
	$ 1,355	$ 1,197

Pension plans

Under US GAAP, the accrued benefit obligation for the defined benefit pension plans as at December 31, 2005 is $11,959 (2004- $10,283).

Consolidated statement of operations

The components of depreciation, amortization and obsolescence for the periods presented below are as follows:

	Year Ended Dec 31, 2005	Period Ended Dec 31, 2004	Nine Months Ended Sept 30, 2004
Depreciation of tangible assets	$ 374	$ 89	$ 332
Amortization of intangible assets	98	17	39
Obsolescence provision on spare parts, materials and supplies	13	3	14
	$ 485	$ 109	$ 385

The components of other operating expenses for periods presented below are as follows:

	Year Ended Dec 31, 2005	Period Ended Dec 31, 2004	Nine Months Ended Sept 30, 2004
Terminal handling and services	$ 201	$ 47	$146
Building rent and maintenance	125	31	93
Flight and cabin crew expense	121	28	89
Credit card fees	158	28	97
Miscellaneous fees and services	104	22	58
Advertising and promotion [(a)]	75	25	70
Customer maintenance and materials	82	28	55
Other	714	149	493
	$ 1,580	$ 358	$ 1,101

(a) Advertising and promotion costs are expensed when incurred.

Rent Expense

Rent expense, including aircraft rent, building and other equipment rentals, amounts to $557 ($113 for the period ended December 31, 2004 under the Corporation and $484 for the nine months ended September 30, 2004 under the Predecessor Company).

Capital lease commitments

As at December 31, 2005, obligations under capital leases for future minimum lease payments are as follows:

2006	$ 240
2007	263
2008	248
2009	151
2010	142
Thereafter	945
Total minimum lease payments	**1,989**
Less amount representing interest	(624)
Total obligations under capital lease	**$ 1,365**

Valuation and Qualifying Accounts and Reserves	Balance at Beginning of Year	Additions charged to costs and expenses	Deductions/ Other	Balance at end of Year
Allowance for obsolescence of spare parts, materials and supplies				
Predecessor Company nine months ended September 30, 2004	$ 151	$ 14	$ (165)	$ -
Successor Company three months ended December 31, 2004	-	3	-	3
Successor Company 2005	**$ 3**	**$ 13**	**$ -**	**$ 16**
Allowance for uncollectible accounts				
Predecessor Company nine months ended September 30, 2004	$ 14	$ 12	$ (9)	$ 17
Successor Company three months ended December 31, 2004	17	2	(3)	16
Successor Company 2005	**$ 16**	**$ 2**	**$ (5)**	**$ 13**
Future income tax valuation allowance				
Predecessor Company nine months ended September 30, 2004	$ 1,655	$ 678	$ -	$ 2,333
Successor Company three months ended December 31, 2004	2,333	1	-	2,334
Successor Company 2005	**$ 2,334**	**$ -**	**$ (17)**	**$ 2,317**

Upon the application of fresh start reporting, spare parts, materials and supplies were adjusted to replacement cost.

New Accounting Policies

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"). This standard replaces SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") and supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). It requires that the compensation cost of share-based payment transactions be recognized in financial statements based on the fair value of the equity or liability instruments issued. SFAS 123R is effective for public companies beginning with the first annual period that begins after June 15, 2005. The Corporation will adopt this statement as of the beginning the first quarter 2006. The Corporation has not completed its evaluation of the impact of SFAS 123R on its financial statements. Under Canadian GAAP as described in note 2, the fair value of stock options granted is recognized as a charge to salary and wage expense on a straight line basis over the applicable vesting period, with an offset to contributed surplus. The amount of compensation cost recognized at any date at least equals the value of the vested portion of the options at that date. When stock options are exercised, the consideration paid by employees, together with the amount in contributed surplus, is credited to share capital.

13. Aeroplan Dilution Gain Adjustment (unaudited)

During the course of preparing the annual 2005 consolidated financial statements, it was noted that the Aeroplan gain calculation, as reported in the three month period ended June 30, 2005, did not take into account the goodwill that is allocated to Aeroplan. As a result the dilution gain for US GAAP purposes, previously reported at $190 less tax of $28, has been decreased by $60 to $108 less tax of $6.

As a result of this adjustment the interim periods in 2005 have been adjusted as follows:

- The income for the three month period ended June 30, 2005, previously reported at $142, has been restated to $82.
- The income for the six month period ended June 30, 2005, previously reported at $46, has been restated to a loss of $14.
- The income for the nine month period ended September 30, 2005, previously reported at $370, has been restated to $310.

This adjustment does not impact the amounts reported under Canadian GAAP.

24. SUBSEQUENT EVENTS

JAZZ AIR INCOME FUND

On February 2, 2006, the Jazz Air Income Fund ("the Fund") sold 23.5 million units at a price of $10 per unit for net proceeds of approximately $222. The Fund is an unincorporated, open-ended trust created to indirectly acquire and hold 19.1% of the outstanding limited partnership units of Jazz. ACE holds the remaining 80.9% of the outstanding limited partnership units of Jazz LP.

The Fund has granted to the underwriters an over-allotment option (the "Over-Allotment Option"), exercisable for a period of 30 days following the Closing Date, to purchase up to 3.525 million additional units at $10 per unit for net proceeds of $33. In the event the underwriters exercise the Over-Allotment Option in full, the Fund and ACE will hold 22% and 78% of the outstanding limited partnership units of the Jazz LP respectively.

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

In connection with the offering, the establishment of $150 senior secured syndicated credit facilities was completed. On closing of the offering, $115 was drawn under the credit facilities. The facility bears interest at floating rates and has a three year term.

NON-UNIONIZED LABOUR REDUCTIONS

In February, 2006 the Corporation announced that certain ACE companies will proceed with the reduction of non-unionized staffing levels by 20%. The non-unionized staff reductions are expected to take place primarily at Air Canada, Air Canada Cargo, ACGHS, and ACTS. The costs of this program will be recorded during the first quarter 2006 once the details of the plan are finalized.

OFFICIAL LANGUAGES UPDATE

Throughout 2005, the various ACE companies continued to maintain their strong commitment with respect to providing services in the language of the customer's choice. Again this year, several initiatives were undertaken to improve bilingual customer service on the ground as well as on board aircraft.

Air Canada continues to provide translation services and language testing to ensure frontline employees maintain their language skills, and efforts continue to allow employees to improve those skills through specific training programmes, such as new language training workshops for customer-contact employees. Language training is offered on Company time for Air Canada Groundhandling and Air Canada call centre employees while Flight attendants, who attend language training on their own time, are granted an incentive premium.

One significant area of concern has been the difficulty in recruiting adequate numbers of qualified bilingual candidates outside the province of Quebec, the National Capital Region, and parts of New Brunswick. In most areas of the country, sufficient numbers of qualified bilingual candidates simply do not exist in order to meet the requirements of several ACE companies including Air Canada, Jazz and Air Canada Groundhandling. As a result, in order to improve bilingual recruitment, the various ACE companies have built reliable networks of partners who help reach out to local communities across Canada.

Throughout 2005, ACE companies including Air Canada, Air Canada Groundhandling Services and Air Canada Jazz received few complaints related to language of service. Air Canada has replaced its on board Comment Card to supply an e-mail address – ollo@aircanada.ca – which allows customers to transmit their feedback conveniently.

Consolidated Operations
Quarterly Financial and Operating Data
(unaudited)

	Predecessor Company - Air Canada		
	2004 Quarter 1	2004 Quarter 2	2004 Quarter 3
Financial data ($ millions)			
Operating revenues	2,121	2,221	2,496
Operating income (loss) before reorganization and restructuring items	(145)	22	243
Income (loss) before non-controlling interest, foreign exchange and income taxes	(320)	(476)	(201)
Income (loss) for the period	(304)	(510)	(81)
Cash flows from (used for) operations	63	114	183
Operating statistics			
Revenue passenger miles (millions)	10,057	10,836	12,853
Domestic	3,013	3,521	4,094
International	7,044	7,315	8,759
Available seat miles (millions)	13,797	13,931	15,993
Domestic	4,196	4,564	5,200
International	9,601	9,367	10,793
Passenger load factor	72.9 %	77.8 %	80.4 %
Domestic	71.8 %	77.1 %	78.7 %
International	73.4 %	78.1 %	81.2 %
Yield per revenue passenger mile (excluding Aeroplan) (cents) (2)	16.5	17.0	16.5
Yield per revenue passenger mile (including Aeroplan) (cents) (2)	16.5	17.0	16.5

(1) Annual Supplementary Non-GAAP Combined Information (Combined) is the combination of financial results for the nine months ended September 30, 2004 of the Predecessor Company and financial results of ACE for the period ended December 31, 2004. Refer to the section "Non-GAAP Financial Measures" of the 2005 MD&A for additional information.

ACE	Combined (1)	ACE				
2004 Quarter 4	2004 Year	2005 Quarter 1	2005 Quarter 2	2005 Quarter 3	2005 Quarter 4	2005 Year
2,062	8,900	2,177	2,458	2,833	2,362	9,830
(3)	117	(10)	177	320	(35)	452
(50)	(1,047)	(73)	281	282	(123)	367
15	(880)	(77)	168	270	(103)	258
(426)	(66)	314	339	(12)	34	675
9,681	43,427	10,586	11,613	13,981	10,584	46,764
3,187	13,815	3,134	3,828	4,537	3,416	14,915
6,494	29,612	7,452	7,785	9,444	7,168	31,849
12,815	56,536	13,566	14,487	16,961	13,808	58,822
4,119	18,079	4,076	4,744	5,514	4,393	18,727
8,696	38,457	9,490	9,743	11,447	9,415	40,095
75.5 %	76.8 %	78.0 %	80.2 %	82.4 %	76.7 %	79.5 %
77.4 %	76.4 %	76.9 %	80.7 %	82.3 %	77.8 %	79.6 %
74.7 %	77.0 %	78.5 %	79.9 %	82.5 %	76.1 %	79.4 %
16.9	16.7	15.9	17.4	16.9	17.9	17.0
17.3	16.8	16.4	18.1	17.6	18.6	17.6

(2) Beginning in October 2004, Aeroplan redemption revenues related to points redeemed for travel on Air Canada and Jazz are reflected in the Passenger revenue category. Prior to October 2004, these revenues were recorded in the Other revenue category. Refer to the section "Aeroplan Loyalty Program" of the 2005 MD&A for additional information.

Ten Year Comparative Review
Financial data - consolidated ($ millions)

	2005	Combined [1] 2004 [2]	2003 [2]
Operating revenues:			
Passenger	8,269	7,309	6,858
Cargo	620	556	519
Other	941	1,035	996
	9,830	**8,900**	**8,373**
Operating expenses:			
Salaries, wages and benefits	2,520	2,585	2,828
Aircraft fuel	2,198	1,606	1,253
Aircraft rent	417	632	1,008
Airport and navigation fees	924	814	743
Depreciation, amortization and obsolescence	482	397	366
Other	2,837	2,749	2,859
	9,378	**8,783**	**9,057**
Operating income (loss) before the undernoted items:	452	117	(684)
Non-recurring labour expenses	-	-	-
Reorganization and restructuring items	-	(871)	(1,050)
Non-operating income (expense):			
Aeroplan dilution gain	190	-	-
Net interest expense	(235)	(210)	(86)
Gain (loss) on sale of and provisions on assets	(28)	(75)	(168)
Other	(12)	(8)	(28)
Total non-operating income (expense)	**(85)**	**(293)**	**(282)**
Income (loss) before the following items:	367	(1,047)	(2,016)
Non-controlling interest	(24)	-	-
Gain (loss) on foreign exchange	46	182	137
Recovery of (provision for) income taxes [4]	(131)	(15)	12
Income (loss) for the year	**258**	**(880)**	**(1,867)**
Cash flows from (used for):			
Operating	675	(66)	139
Financing	801	1,504	22
Investing	(1,392)	(441)	(49)
Change in short-term investments	465	(35)	-
Increase (decrease) in cash, cash equivalents and short-term investments	549	962	112
Cash, cash equivalents and short-term investments	2,181	1,632	670
Operating margin [5]	4.6%	1.3%	(8.2)%
EBITDAR [5] [6]	1,351	1,146	690
EBITDAR % [5] [6]	13.7 %	12.9 %	8.2 %
Current ratio	1.11	1.08	0.71
Total assets	11,847	9,386	6,910
Long-term debt and capital lease obligations (including current portion) (excluding perpetual debt)	3,808	2,546	505
Subordinated perpetual debt	-	-	-
Liabilities subject to compromise	-	-	5,313
Convertible preferred shares	148	132	-
Shareholders' equity	1,168	203	(4,155)
Net debt (excluding perpetual debt) to debt plus equity [7]	60 %	84 %	Note 2
Earnings (loss) per diluted share [8]	$2.46	Note 8	($15.53)
Book value per share [8]	$11.47	Note 8	($34.57)

(1) Annual Supplementary Non-GAAP Combined Information (Combined) is the combination of financial results for the nine months ended September 30, 2004 of the Predecessor Company and financial results of ACE for the period ended December 31, 2004. Refer to section "Non-GAAP Financial Measures" of the 2005 MD&A for additional information.

(2) Under creditor protection (CCAA) from April 1, 2003 to September 30, 2004.

(3) Includes Canadian Airlines financial results following its acquisition by Air Canada effective June 30, 2000.

(4) In the fourth quarter 2002, the Corporation recorded a $400 million valuation allowance as a charge to earnings; $453 million in the third quarter 2001.

(5) Before non-recurring labour expenses and reorganization and restructuring items.

Predecessor Company - Air Canada						
2002	2001	2000 (3)	1999	1998	1997	1996
8,190	8,123	7,949	5,520	4,977	4,533	3,980
585	578	542	387	369	387	347
1,051	910	805	536	552	612	513
9,826	**9,611**	**9,296**	**6,443**	**5,898**	**5,532**	**4,840**
3,099	3,022	2,570	1,760	1,594	1,428	1,323
1,288	1,593	1,371	622	657	712	640
1,109	959	713	513	474	383	319
772	738	657	492	375	228	200
372	441	408	311	292	258	258
3,378	3,589	3,316	2,368	2,411	2,230	1,914
10,018	**10,342**	**9,035**	**6,066**	**5,803**	**5,239**	**4,654**
(192)	(731)	261	377	95	293	186
(26)	-	(178)	-	-	-	-
-	-	-	-	-	-	-
-	-	-	-	-	-	-
(221)	(275)	(210)	(154)	(174)	(134)	(157)
(42)	(85)	15	57	30	236	133
97	126	37	29	3	16	8
(166)	**(234)**	**(158)**	**(68)**	**(141)**	**118**	**(16)**
(384)	(965)	(75)	309	(46)	411	170
-	-	-	-	-	-	-
(60)	(20)	78	205	(414)	104	236
(384)	(330)	(39)	(165)	113	(68)	(58)
(828)	**(1,315)**	**(36)**	**349**	**(347)**	**447**	**348**
(95)	(1,072)	140	680	284	366	64
(310)	1,718	524	(378)	72	(129)	118
(104)	(16)	(748)	(147)	(640)	(42)	(502)
-	-	-	-	-	-	-
(509)	630	(84)	155	(284)	195	(320)
558	1,067	437	521	366	650	455
(2.0) %	(7.6) %	2.8 %	5.9 %	1.6 %	5.3 %	3.8 %
1,289	669	1,382	1,201	861	934	763
13.1 %	7.0 %	14.9 %	18.6 %	14.6 %	16.9 %	15.8 %
0.68	0.78	0.63	0.84	0.81	1.17	0.92
7,412	8,744	9,681	6,772	6,409	6,043	5,500
3,494	3,939	3,300	2,414	2,065	1,879	2,142
1,193	1,172	1,250	1,365	1,553	1,304	1,399
-	-	-	-	-	-	-
-	-	-	-	-	-	-
(2,288)	(1,460)	(145)	(144)	452	761	291
159 %	111 %	74 %	61 %	46 %	37 %	50 %
($6.89)	($10.95)	($0.30)	$1.88	($1.96)	$2.48	$1.89
($19.04)	($12.15)	($1.21)	($1.20)	$2.40	$4.86	$1.87

(6) 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 depreciation, amortization and obsolescence as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. 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.

(7) Includes current portion of long-term debt, bank indebtedness and convertible preferred shares, and is net of cash, cash equivalents and short-term investments.

(8) Earnings (loss) per share for the nine months ended 2004 (Predecessor Company) was $(7.45), and for the period ended December 31, 2004 was $0.17. The book value per share for the nine months ended 2004 (Predecessor Company) was $(5.08), and for the period ended December 31, 2004 was $2.29.

Ten Year Comparative Review (Cont'd)
Operating Statistics

	Consolidated Operations		
		Combined (1)	
	2005	2004	2003
Passenger - Scheduled and Charter:			
Revenue passengers carried (millions) (4)	30.0	27.4	21.2
Revenue passenger miles (millions) (4)	46,764	43,427	37,888
Available seat miles (millions)	58,822	56,536	51,340
Passenger load factor (4)	79.5 %	76.8 %	73.8 %
Yield per revenue passenger mile (excluding Aeroplan) (cents) (4) (5)	17.0	16.7	15.9
Yield per revenue passenger mile (including Aeroplan) (cents) (4) (5)	17.6	16.8	n/a
Yield per available seat mile (excluding Aeroplan) (cents)	13.5	12.8	11.7
Yield per available seat mile (including Aeroplan) (cents)	14.0	12.9	n/a
Cargo - Scheduled and Charter:			
Revenue ton miles (millions)	1,169	1,051	974
Yield per revenue ton mile (cents)	53.1	52.9	51.3
Other Measures:			
Operating expense per available seat mile (cents) (6)	15.9	15.5	15.4
Average number of full-time equivalent employees (thousands)	32.5	32.5	31.5
Available seat miles per employee (thousands)	1,811	1,738	1,628
Revenue per employee ($ thousands)	303	274	232
Average aircraft utilization (hours per day) (7)	10.6	10.2	10.3
Average aircraft flight length (miles) (8)	871	847	1,218
Fuel price per litre (cents)	60.0	46.2	37.1
Fuel litres (millions)	3,641	3,460	3,101
Operating Statistics - Consolidated			
Revenue passenger miles (millions) (4)			39,565
Available seat miles (millions)			54,160
Passenger load factor (4)			73.1 %
Yield per revenue passenger mile (cents) (4) (5)			17.3

(1) Annual Supplementary Non-GAAP Combined Information (Combined) is the combination of financial results for the nine months ended September 30, 2004 of the Predecessor Company and financial results of ACE for the period ended December 31, 2004. Refer to section "Non-GAAP Financial Measures" of the 2005 MD&A for additional information.

(2) Mainline-related operations include the operations of Air Canada, Air Canada Cargo, ACGHS, ACTS and Aeroplan. Mainline-related operating statistics exclude Jazz operations and capacity purchase arrangements with third party carriers. Beginning in 2004, the operating statistics reflected above are based on consolidated operations.

(3) Includes Canadian Airlines financial results following its acquisition by Air Canada effective June 30, 2000.

(4) Revenue passengers carried and revenue passenger miles include frequent flyer redemptions. 1996 through 2000 revenue passengers carried restated to conform to the IATA definition of passengers carried.

Mainline-Related Operations (2)			Predecessor Company - Air Canada			
2002	2001	2000 (3)	1999	1998	1997	1996
23.1	23.1	21.2	16.2	16.2	15.6	14.5
43,135	41,651	35,658	24,242	23,211	22,788	20,596
57,325	57,104	49,229	33,970	32,719	32,061	29,431
75.2 %	72.9 %	72.4 %	71.4 %	70.9 %	71.1 %	70.0 %
17.0	17.0	19.5	19.8	18.8	17.5	16.4
n/a	n/a	n/a	n/a	n/a	n/a	n/a
12.8	12.4	14.1	14.1	13.3	12.5	11.5
n/a	n/a	n/a	n/a	n/a	n/a	n/a
1,187	1,170	1,125	863	833	895	783
47.7	47.6	46.3	43.2	42.7	41.1	41.6
15.6	16.0	16.3	15.9	15.8	14.3	13.4
34.8	37.5	31.6	23.0	22.8	21.2	19.9
1,649	1,524	1,560	1,478	1,433	1,516	1,481
253	226	262	249	229	230	207
10.7	10.7	11.1	10.8	10.3	10.4	10.7
1,225	1,217	1,157	1,014	955	944	957
33.7	38.9	38.0	24.6	26.3	27.5	26.3
3,529	3,693	3,234	2,276	2,251	2,235	2,080
44,707	43,723	37,536	25,623	24,479	23,896	21,894
60,169	60,637	52,553	36,438	35,037	34,117	31,988
74.3 %	72.1 %	71.4 %	70.3 %	69.9 %	70.0 %	68.4 %
18.3	18.5	21.2	21.5	20.3	18.9	18.1

(5) Beginning in October 2004, Aeroplan redemption revenues related to points redeemed for travel on Air Canada and Jazz are reflected in the Passenger revenue category. Prior to October 2004, these revenues were recorded in the Other revenue category. Refer to section "Aeroplan Loyalty Program" of the 2005 MD&A for additional information.

(6) Includes a repayment of fuel excise tax rebate in 1997 of $43 million (not consolidated).

(7) Excludes maintenance down-time.

(8) Excludes third party carriers operating under capacity purchase arrangements.

OFFICERS AND DIRECTORS

OFFICERS

Robert A. Milton	Chairman, President and Chief Executive Officer
Brian Dunne	Executive Vice President and Chief Financial Officer
Greg Cote	Senior Vice President, Corporate Finance and Strategy
Duncan Dee	Senior Vice President, Corporate Affairs and Chief Administrative Officer
Sydney John Isaacs	Senior Vice President, Corporate Development and Chief Legal Officer
Jack McLean	Controller
Carolyn M. Hadrovic	Corporate Secretary

BOARD OF DIRECTORS — ACE AVIATION HOLDINGS INC.

Robert A. Milton	Chairman, President & Chief Executive Officer, ACE Aviation Holdings Inc. and Chairman Air Canada, Aeroplan Holding GP Inc., Jazz Air Holding GP Inc. and ACTS General Partner Inc., Westmount, Quebec
Bernard Attali	Country Advisor, Texas Pacific Group France, Paris, France
Robert E. Brown	President & Chief Executive Officer, CAE Inc., Westmount, Quebec
Carlton D. Donaway	Senior Advisor – Operations, Cerberus Capital Management, L.P., Redmond, Washington
Michael M. Green	Managing Director and President – Operations, Cerberus Capital Management, L.P., Radnor, Pennsylvania
W. Brett Ingersoll	Managing Director, Cerberus Capital Management, L.P., New York, New York
Pierre Marc Johnson	Senior Counsel, Heenan Blaikie L.L.P., Montreal, Quebec
Richard H. McCoy	Corporate Director, Toronto, Ontario
John T. McLennan	Corporate Director, Mahone Bay, Nova Scotia
David I. Richardson	Corporate Director, Grafton, Ontario
Marvin Yontef	Senior Partner, Stikeman, Elliott L.L.P., Toronto, Ontario

Investor and Shareholder Information

Price Range and Trading Volume of ACE Variable Voting Shares (ACE.RV)*

2005	High	Low	Volume Traded
1st Quarter	$ 38.50	$ 31.25	45,363,192
2nd Quarter	$ 43.03	$ 33.00	66,943,750
3rd Quarter	$ 41.25	$ 34.02	45,153,531
4th Quarter	$ 39.96	$ 30.25	48,185,285

* Effective May 8, 2006, new trading symbol (ACE.A)

Price Range and Trading Volume of ACE Voting Shares (ACE.B)

2005	High	Low	Volume Traded
1st Quarter	$ 38.83	$ 31.25	8,713,195
2nd Quarter	$ 43.00	$ 33.00	9,950,846
3rd Quarter	$ 41.22	$ 34.00	10,579,805
4th Quarter	$ 40.01	$ 30.29	18,813,238

Duplicate Communication

Shareholders receiving more than one copy are requested to call 1-800-387-0825 or write to the Transfer Agent and Registrar, CIBC Mellon Trust Company at the following address: 2001 University Street, Suite 1600, Montreal, Quebec H3A 2A6

Inquiries may be submitted by electronic mail to inquiries@cibcmellon.com

Restrictions on Voting Securities

The Air Canada Public Participation Act and the articles of Air Canada limit ownership of the airline's voting interests by all non-residents of Canada to a maximum of 25%. The Canada Transportation Act (CTA) also requires that Canadians own and control at least 75% of the voting interests of licensed Canadian carriers. Since Air Canada and Air Canada Cargo are licence holders and wholly-owned subsidiaries of ACE and Air Canada Jazz is a licence holder of which ACE holds a majority interest, ACE's articles contain restrictions to ensure that it remains "Canadian" as defined under the CTA. The restrictions in ACE's articles provide that non-Canadians can only hold variable voting shares of ACE, that such variable voting shares will not carry more than 25% of the aggregate votes attached to all issued and outstanding voting shares and that the total number of votes cast by the holders of such variable voting shares at any meeting will not exceed 25% of the votes that may be cast at such meeting.

Glossary of Terms

Revenue Passenger Miles (RPMs)
Total number of revenue passengers carried multiplied 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.

Revenue Ton Miles (RTMs)
Total number of cargo tons carried multiplied by the miles they are carried.

Yield per RPM
Average revenue per revenue passenger mile.

For Further Information

Shareholder Relations
Assistant Secretary, Shareholder Relations
Telephone: (514) 205-7856
Facsimile: (514) 205-7859

Investor Relations
Director, Investor Relations
Telephone: (514) 422-7849
Facsimile: (514) 422-7877

Head Office
ACE Aviation Holdings Inc.
5100 de Maisonneuve Blvd. West
Montreal, Quebec H4A 3T2

Internet
www.aceaviation.com

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Transfer Agents and Registrar
CIBC Mellon Trust Company
Telephone: 1 800 387-0825
Halifax, Montreal, Toronto,
Calgary and Vancouver.

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ACE AVIATION

Corporate Profile

ACE is the parent holding company of Air Canada and ACE's other subsidiaries.

Air Canada is Canada's largest domestic and international full-service airline and the largest provider of scheduled passenger services in the domestic market, the transborder market and each of the Canada-Europe, Canada-Pacific, Canada-Caribbean/Central America and Canada-South America markets. Passenger transportation is the principal business of the Corporation and, in 2005, represented 84% of its total operating revenues.

Air Canada and Jazz, the Corporation's regional carrier, operate an extensive domestic, transborder and international network. During 2005, Air Canada and Jazz operated, on average, approximately 1,200 scheduled flights each day and carried over 30 million passengers. In 2005, Air Canada and Jazz provided direct passenger air transportation to 159 destinations and, through commercial agreements with other unaffiliated regional airlines referred to as tier III carriers, to an additional 11 destinations, for a total of 170 direct destinations on five continents. The Corporation's primary hubs are located in Toronto, Montreal, Vancouver and Calgary.

Air Canada also operates an extensive global network in conjunction with its international partners. Air Canada is a founding member of the Star Alliance, the world's largest airline alliance group. The Star Alliance has grown, since its inception, to include 16 members and three regional members. Through its strategic and commercial arrangements with Star Alliance members and several other airlines, Air Canada offers service to over 795 destinations in 139 countries, with reciprocal participation in frequent flyer programs and use of airport lounges.

The Corporation holds a 75.5% interest in Aeroplan LP, which operates Canada's premier loyalty program, with approximately five million active members, and a 79.7% interest in Jazz Air LP, the Corporation's regional carrier. The Corporation also provides Technical Services through ACTS LP, Cargo Services through AC Cargo LP and Air Canada, Groundhandling Services through ACGHS LP and Air Canada, and tour operator services and leisure vacation packages through Touram LP.

aceaviation.com