Research Opinion

June 15, 2006 **Privileged**

Independent Research Opinion regarding the estimated cost of proposed pilot wage increases at Air Canada

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ACE Aviation Holdings Ltd. (TSX: ACE.B)

Backgrounder

Wage renegotiation talks between Air Canada, the mainline carrier division of ACE Aviation, and the Air Canada Pilots Association ("ACPA") broke down last week. Both parties must now head to mediation and potentially, to binding arbitration. As part of concessions given up during the airline's bankruptcy restructuring between 2003 and 2004, ACPA and other unions were permitted to enter wage re-opener talks this year; however, Air Canada workers are unable to legally strike, or be locked out, until 2009.

ACPA represents 3,100 pilots at Air Canada, representing more commercial airline pilots in Canada than any other union. Until the two sides ended their most recent discussions, a media report stated that ACPA had been looking for an 18 percent pay hike this year, retroactive to June 2nd, three percent in mid-2007 and a further three percent in mid-2008. Discussions related to pensions and other benefits were also reputedly discussed at the bargaining table.

AirTrav Inc. believes that the above stated ACPA position is most likely true. ACPA members took the largest wage reduction of any labour group at Air Canada as a result of the company's bankruptcy restructuring, and the pilots are looking to recoup that entire amount plus inflation. ACPA also agreed at the time to change in work rules. A recent ACPA news release reinforces the basis for this position.

As of the date of this Research Opinion, Air Canada had not made public the terms of its recent talks with pilots. However, according to ACPA the company's offer was stingy, essentially a status quo offer because the negotiators had "no mandate to offer anything that would increase costs." The related ACPA memo went on to say that during talks, management delivered a "doom and gloom financial roll down" and "obsessed about high fuel prices".

AirTrav believes that Air Canada made no specific wage counteroffer in its initial talks with ACPA, knowing that negotiations were likely to proceed into mediation and ultimately to binding arbitration. Furthermore, Air Canada's opening position will likely see wage increases limited to at or just below the rate of core CPI.

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In its May 29th news release, ACPA stated that the company plans to hire 500 pilots over the next two years to "cover off growth, retirements and the improved financial position of the airline." No figure has been made available by Air Canada.

Growth in Pilot Headcounts

Notwithstanding estimated current vacancies on certain fleet types and likely idiosyncrasies from the bankruptcy period negotiations that would have placed limitations on new hire movements from regional jets and which also projected flat growth through 2010, AirTrav has estimated net growth in pilot headcounts over the three-year period at a lower rate than that quoted by ACPA.

AirTrav Inc. believes Air Canada will hire 325 pilots over the next two years, with 183 to cover-off attrition (mostly retirements) and 143 earmarked for growth and some current vacancies. It will not be until three years from now that a level of 500 new hire pilots will be reached, with 281 to cover-off attrition and 219 for growth.

Our forecast for attrition and hiring means that ACPA will represent 3243 pilots at Air Canada two years from now, and 3319 within three years, up from 3100 today.

Changes to pilot headcounts are summarized in the below table:

Pilot Headcounts - Mainline Air Canada

June 2006 - May 2009

% Change	Attrition-loss	Attrition-hire	Growth	**Net Change**		
2006 - 2007	-3.0%	3.0%	3.0%	**3.0%**		
2007 - 2008	-3.0%	3.0%	1.8%	**1.8%**		
2008 - 2009	-3.0%	3.0%	2.3%	**2.3%**		
Actual Change	Attrition-loss	Attrition-hire	Growth	**Net Change**	**New Hires**	**ACPA Pilots**
Current						3,100
2006 - 2007	-86	86	86	**86**	**173**	3,186
2007 - 2008	-96	96	56	**56**	**153**	3,243
2008 - 2009	-98	98	77	**77**	**175**	3,319
2 & 3 year totals:						
2006 - 2008	-183	183	143	**143**	**325**	
2006 - 2009	-281	281	219	**219**	**500**	

Source: ACPA news release, 29/05/2006; AirTrav Inc. estimates and forecasts.

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Comparison of Offers

Based on ACPA's quoted position on wage increases, projections from AirTrav regarding pilot headcount growth and Air Canada's assumed opening wage position, AirTrav Inc. has estimated the financial impact on salaries and benefits for the three-year period June 2006 through May 2009.

Using AirTrav growth projections, the ACPA position would increase Air Canada salaries and benefits expense by $291-million CAD over the next three years, which averages out to $97-million per year on a straight line basis. The corresponding compound average annual growth rate is 7.8%, based on an increase of 18.0% in the first year, 3.0% in year two and 3.0% in year three.

The estimated Air Canada opening position, using AirTrav growth projections, would increase the company's salaries and benefits expense by $57-million over the next three years, which averages out to $19-million on a straight line basis. The corresponding compound average annual growth rate is 2.3%, based on a rise of 1.5% in the first year, 2.5% in year two, and 3.0% in year three.

Pilots' Compensation - Mainline Air Canada

June 2006 - May 2009

	Pilot Salaries & Benefits[3]			**Increase vs. Current - $**		**Increase vs. Current - %**	
CAD Millions	New Positions (est'd)		AC	New Positions (estimated)		New Positions (estimated)	
	ACPA[1]	Air Canada[2]	Current[2]	ACPA	Air Canada	ACPA	Air Canada
TOTAL - 3 years	$1,636	$1,403	$1,345	$291	$57	21.6%	4.3%
	Average Annual Increase > > >			$97	$19	**7.8%**	**2.3%**

Sources & Notes:

[1] *ACPA news release, 29/05/2006; The Globe And Mail, 13/06/2006, AirTrav estimates.*

[2] *AirTrav Inc. estimates.*

[3] *Benefits excludes pension impact.*

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Conclusion

AirTrav believes that the ACPA position, as known, is not sustainable given labour pressures from other internal groups now, and from all labour groups beyond the 2009 milestone when strikes and lockouts will again be permitted. More importantly, continuing and significant pressure from aircraft fuel will likely see prices and volatility grow for some time to come, hampering Air Canada's ability to pay for cost increases in excess of core inflation rates.

On the revenue side, passenger yields have been steadily improving for the past five quarters across Air Canada's domestic, US transborder and international markets. However, there is still no guarantee for long-term yield growth or stability. Competition continues to be fierce across all markets: WestJet is continuing its domestic and transborder expansion, US carriers are shedding costs and improving revenue generating capabilities, and several international carriers such as British Airways and non-scheduled carriers including Air Transat and Zoom Airlines are making further increases to capacity and changes to pricing on routes that compete with Air Canada.

The airline industry is highly cyclical and often forms the leading edge of pending growth and contractions across national and global economies. Fuel costs excluded, the airline sector is as profitable today as it was back in 1999. Unfortunately, high-energy prices are eroding what otherwise would be an uptick in the airline sector's normal business cycle.

As such, Air Canada and its assorted labour groups including ACPA, must prepare for the eventual downcycle. Returning labour costs to pre-restructuring levels in an environment of soaring fuel costs, rising interest rates, uncertain yields, plus continuing instability in global geopolitical affairs could return Air Canada to restructuring mode, acting as a primary catalyst for when, and not if, the next downcycle hits.

Per AIRTRAV INC.

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President & Managing Director

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