



# Jazz Air Income Fund

## Management's Discussion and Analysis

Three and Six Months Ended  
June 30, 2010

August 3, 2010



## TABLE OF CONTENTS

1. OVERVIEW .....	2
2. HIGHLIGHTS .....	4
3. SUMMARY OF CONSOLIDATED STATEMENT OF INCOME .....	5
4. SECOND QUARTER ANALYSIS .....	6
5. YEAR-TO-DATE ANALYSIS .....	7
6. PERFORMANCE INDICATORS .....	8
7. QUARTERLY FINANCIAL DATA .....	12
8. LIQUIDITY AND CAPITAL RESOURCES .....	12
9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT .....	14
10. ECONOMIC DEPENDENCE .....	15
11. PENSION PLANS .....	18
12. CRITICAL ACCOUNTING ESTIMATES .....	18
13. ACCOUNTING POLICY CHANGES AND DEVELOPMENTS .....	19
14. FLEET .....	21
15. CONTROLS AND PROCEDURES .....	22
16. OUTLOOK .....	23
17. RISK FACTORS .....	23
18. GLOSSARY OF TERMS .....	24

The following management's discussion and analysis of financial condition and results of operations ("MD&A") of Jazz Air Income Fund ("the Fund") for the three and six months ended June 30, 2010 should be read in conjunction with the accompanying unaudited interim consolidated financial statements of the Fund for the three and six months ended June 30, 2010, the audited consolidated financial statements of the Fund for the year ended December 31, 2009, the annual MD&A dated February 9, 2010, and the Fund's Annual Information Form dated March 30, 2010. The audited consolidated financial statements of the Fund and the unaudited interim consolidated financial statements of the Fund are prepared in accordance with generally accepted accounting principles ("GAAP") in Canada. This MD&A is prepared as at August 3, 2010.

The Fund is entirely dependent upon the operations and financial condition of Jazz Air LP (the "Partnership"), which carries on the business activities described in this MD&A. The earnings and cash flows of the Fund are affected by certain risks (refer to Section 17 - Risk Factors).

The Fund has discontinued its prior practice of including in its MD&A certain detailed data that could be used to determine pricing and/or other commercially sensitive information regarding its relationship with customers.

This MD&A complies, in all material respects, with the recommendations provided in the Canadian Institute of Chartered Accountants ("CICA") publication, *Standardized Distributable Cash in Income Trusts and Other Flow-Through Entities: Guidance on Preparation and Disclosure*.

Except where the context otherwise requires, all monetary amounts are stated in thousands of Canadian dollars.

For further information on the Fund's public disclosure file, including the Fund's Annual Information Form, please consult SEDAR at [www.sedar.com](http://www.sedar.com).

### Caution regarding forward-looking information

Forward-looking statements are included in this MD&A. 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 relate to analyses and other information that are based on forecasts of future results, estimates of amounts not yet determinable and other uncertain events. Forward-looking statements, by their nature, are based on assumptions, including those described below, 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. Such statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements to differ materially from those expressed in the forward-looking statements. Results indicated in forward-looking statements may differ materially from actual results for a number of reasons, including without limitation, risks relating to the Partnership's relationship with Air Canada, risks relating to the airline industry,



energy prices, general industry, market, credit, and economic conditions, competition, insurance issues and costs, supply issues, war, terrorist attacks, epidemic diseases, acts of God, changes in demand due to the seasonal nature of the business, the ability to reduce operating costs and employee counts, secure financing, employee relations, labour negotiations or disputes, restructuring, pension issues, currency exchange and interest rates, changes in laws, adverse regulatory developments or proceedings, pending and future litigation and actions by third parties, as well as the factors identified throughout this MD&A. The forward-looking statements contained in this discussion represent the Fund's expectations as of August 3, 2010, and are subject to change after such date. However, the Fund disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

## 1. OVERVIEW

---

The Fund is an unincorporated, open-ended trust established under the laws of the Province of Ontario by a declaration of trust dated November 25, 2005 as amended by an amended and restated declaration of trust dated January 24, 2006, and an amending agreement dated as of March 23, 2009 (the "Fund Declaration of Trust"). The Fund qualifies as a "mutual fund trust" for the purposes of the Income Tax Act (Canada). The principal and head office of the Fund is located at 1000 de la Gauchetière Street West, Suite 2100, Montréal, Québec H3B 4W5. The Fund has been established to acquire and hold, directly or indirectly, investments in the Partnership and its general partner Jazz Air Holding GP Inc. ("Jazz GP"), a regional airline, and such other investments as the trustees of the Fund (the "Trustees") may determine. During the second quarter of 2010, the Fund incorporated a wholly-owned subsidiary, 7503695 Canada Inc. ("7503695") to acquire and hold an indirect investment in Pluna Líneas Aéreas Uruguayas S.A. ("Pluna") through a direct investment in Latin American Regional Aviation Holding Corp. ("LARAH"). Reference to Jazz in this MD&A refers to, as the context may require, the Fund and its subsidiaries (Jazz Air Trust (the "Trust"), the Partnership, Jazz GP and 7503695) collectively, the Fund and one or more of its subsidiaries, one or more of the Fund's subsidiaries or the Fund itself.

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 transborder market presence. Jazz and Air Canada are parties to the capacity purchase agreement ("CPA"), under which Air Canada currently purchases substantially all of Jazz's fleet capacity at predetermined rates. Under the CPA, 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 operates scheduled passenger service on behalf of Air Canada with approximately 841 departures per weekday to 57 destinations in Canada, and 28 destinations in the United States, using 123 Covered Aircraft. Jazz and Air Canada have linked their regional and mainline networks in order to serve connecting passengers more efficiently and to provide valuable traffic feed to Air Canada's mainline routes.

Under the CPA, Jazz operates flights on behalf of Air Canada. Air Canada controls and is responsible for scheduling, pricing, product distribution, seat inventories, marketing and advertising, and customer service handling at certain airports staffed or administered directly by Air Canada. Air Canada is entitled to all revenues associated with the operation of the Covered Aircraft.

Under the CPA, Jazz is paid fees based on certain variables, including Block Hours flown, flight hours, cycles (number of take-offs and landings) and passengers carried, in addition to certain variable and fixed aircraft ownership rates. Jazz is also entitled to repayment of certain pass-through costs specified in the CPA, including fuel, navigation, landing and terminal fees and certain other costs. Jazz is also eligible to receive incentive payments each quarter for successfully achieving certain performance levels related to on-time performance, controllable flight completion, baggage handling performance and overall customer satisfaction.

During the first quarter of 2009, Jazz reached an agreement with Air Canada regarding the establishment of new rates for Controllable Costs that are payable to Jazz under the CPA for the three year period ending December 31, 2011. The new rates were effective January 1, 2009 and reflected in an amendment to the CPA dated July 6, 2009 (refer to Section 10 - Economic Dependence). Jazz and Air Canada also agreed to amend the terms of the CPA under an amendment dated September 22, 2009 (the "CPA Amending Agreement") in response to uncertainty in the airline industry and Air Canada's need to implement cost reduction initiatives (refer to Section 10 - Economic Dependence). Jazz is directly affected by the financial and operational strength of Air Canada, its competitive position, and its ability to maintain sufficient liquidity (refer to Section 17 - Risk Factors).

Jazz has historically experienced greater demand for its services in the second and third quarters of the calendar year and 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, thereby increasing the



flying hour requirements of Air Canada. Jazz has substantial fixed costs that do not meaningfully fluctuate with passenger demand in the short-term. Jazz revenues under the CPA do not fluctuate significantly with Passenger Load Factors (refer to Section 10 - Economic Dependence).

Most of Jazz's employees are unionized and each of its collective bargaining agreements expired at the end of June 2009. Jazz has pursued negotiations with each union. In 2009, Jazz reached a three year agreement with its maintenance and engineering employees and its Customer Services and Aircraft Services divisions, both represented by the Canadian Auto Workers ("CAW"). On March 27, 2010 Jazz reached a three year agreement with its dispatcher employees represented by the Canadian Air Line Dispatchers Association ("CALDA"). On June 25, 2010, Jazz reached a six year agreement with its pilots represented by the Air Line Pilots Association ("ALPA"), which was ratified on July 9, 2010 by a union vote. On June 30, 2010, Jazz reached a six year agreement with its flight attendants represented by the Canadian Flight Attendants Union ("CFAU"), which was ratified on July 16, 2010 by a union vote. The six year agreements for both the pilots and flight attendants expire June 30, 2015. Negotiations with Jazz's crew schedulers (also represented by CAW) recommenced in mid July.

On April 2, 2010, Jazz signed a flight services agreement with Thomas Cook Canada Inc. ("Thomas Cook") to operate no less than six Boeing 757-200 aircraft on their behalf to various sun destinations from Canadian gateways during the winter season (November through April). Subject to Jazz obtaining the required regulatory approvals and the execution of definitive leasing and maintenance agreements with Thomas Cook Airlines Ltd., the service will commence in November 2010. This agreement is expected to generate approximately \$100.0 million in additional annual revenue.

On April 30, 2010, Jazz completed a \$15.2 million investment in LARAH in return for a 33.3% non-voting equity interest. LARAH holds an indirect 75% equity interest in Pluna. The remaining 25% equity interest in Pluna is held, indirectly by the Government of Uruguay. Jazz has the right to appoint one of the seven directors on the Pluna board of directors.

On April 30, 2010, Jazz signed a purchase agreement with Bombardier Inc., as represented by Bombardier Aerospace Commercial Aircraft ("Bombardier") regarding a firm order for 15 Q400 NextGen turboprop aircraft and options for 15 additional aircraft. Based on the list price for the Q400 NextGen aircraft, the firm order is valued at approximately US\$454.0 million, and could increase to US\$937.0 million if the option to purchase an additional 15 aircraft is exercised. Subject to satisfaction of customary conditions, aircraft deliveries are scheduled to commence in May 2011. As required by the purchase agreement, Jazz made a lump sum predelivery payment during the quarter, and continues to make required payments monthly. As at June 30, 2010, Jazz has recorded \$19.6 million in property and equipment for these predelivery payments, which includes other costs of \$0.4 million. Jazz has received financing commitments from a third party lender for all firm orders covering up to 85% of the net purchase price.

Air Canada's commitment to Jazz's minimum fleet of Covered Aircraft was reduced from 133 to 123 aircraft pursuant to the CPA Amending Agreement. The subleases for eight CRJ-200 and two CRJ-100 aircraft expired April 30, 2010 and these aircraft have been removed from the Jazz fleet. Following the return of these ten aircraft, the Jazz fleet will be temporarily reduced to 123 aircraft. As at June 30, 2010, four of these CRJ aircraft have been returned to the lessor, five continue to be prepared for return to the lessor and one remains in the Jazz fleet pursuant to a new lease arrangement and is being used to operate charter flights. The addition of this one CRJ-200 brings the number of aircraft to five for charter services. Jazz has had to redirect a number of internal staff resources to its aircraft return program as late rent penalties are accruing under the original leases for delays in returning the aircraft.

### **Conversion of Jazz to a Corporation**

During 2010, Jazz intends to pursue a conversion to a corporate structure. As a consequence, certain tax uncertainties described in "Risks Relating to the Structure of Jazz - Income Tax Matters" (refer to Section 17 - Risk Factors) should be alleviated. It is anticipated that the conversion will occur pursuant to a court-approved plan of arrangement which unitholders will be asked to approve at a special meeting to be held in the Fall of 2010. The conversion will require approval of unitholders holding at least 66.6% of the Units of Jazz. If approved, it is anticipated that unitholders will be provided an opportunity to elect to have the exchange occur on a tax deferred basis. Jazz expects the conversion to be effective as of January 1, 2011 (refer to caution regarding forward-looking information on page 1 of this MD&A).



## 2. SECOND QUARTER 2010 HIGHLIGHTS

- Reached new six year agreements with pilots and flight attendants unions, each expiring on June 30, 2015.
- Expanded charter fleet to five aircraft, with the addition of one CRJ-200.
- Billable Block Hours down 4.9% and operating income, before amortization of CPA Asset of \$26.9 million, down 26.8% or \$9.8 million for the three months ended June 30, 2010.
- EBITDA of \$34.0 million for the three months ended June 30, 2010, down \$10.3 million or 23.3%.
- Distributable cash payout ratio of 63.9% for the three months ended June 30, 2010, compared to 76.0%.

### Key statistical information

Statistical information for the three and six months ended June 30, 2010 and 2009 is as follows:

	Three months ended June 30,			Six months ended June 30,		
	2010	2009	Variance %	2010	2009	Variance %
Departures	69,249	71,356	(3.0)	132,810	136,662	(2.8)
Block Hours	93,078	97,218	(4.3)	180,828	189,068	(4.4)
Billable Block Hours	93,585	98,410	(4.9)	183,330	193,951	(5.5)
Available Seat Miles (ASMs) (000's)	1,345,703	1,408,433	(4.5)	2,578,859	2,677,908	(3.7)
Operating Expenses (\$000's)	332,137	336,855	(1.4)	670,682	674,678	(0.6)
Cost per Available Seat Mile (CASM) (¢)	24.68	23.92	3.2	26.01	25.19	3.3
CASM Excluding Aircraft Fuel (¢)	19.38	19.51	(0.7)	20.69	20.73	(0.2)
Number of Operating Aircraft (end of period) <sup>(1)</sup>	128	137	(6.6)	128	137	(6.6)
Full-time Equivalent (FTEs) (end of period)	4,474	4,498	(0.5)	4,474	4,498	(0.5)

(1) Refer to Section 14 - Fleet



### 3. SUMMARY OF CONSOLIDATED STATEMENT OF INCOME

Certain of the following financial information of Jazz has been derived from, and should be read in conjunction with the interim consolidated financial statements for the three and six months ended June 30, 2010 and the related notes.

(expressed in thousands of Canadian dollars, except units and earnings per unit) (unaudited)	Three months ended June 30,			Six months ended June 30,		
	2010	2009	Variance	2010	2009	Variance
	\$	\$	%	\$	\$	%
Operating revenue	359,010	373,569	(3.9)	714,382	743,003	(3.9)
Operating expenses	332,137	336,855	(1.4)	670,682	674,678	(0.6)
Operating income before amortization of CPA asset <sup>(1)</sup>	26,873	36,714	(26.8)	43,700	68,325	(36.0)
Amortization of CPA asset <sup>(1)</sup>	8,048	10,525	(23.5)	16,096	21,050	(23.5)
Operating income	18,825	26,189	(28.1)	27,604	47,275	(41.6)
Non-operating expenses	(3,234)	(811)	298.8	(6,134)	(2,772)	121.3
Income before future income taxes	15,591	25,378	(38.6)	21,470	44,503	(51.8)
Recovery of future income taxes <sup>(2)</sup>	-	-	-	644	1,998	(67.8)
Net income for the period	15,591	25,378	(38.6)	22,114	46,501	(52.4)
Adjusted net income <sup>(3)</sup>	23,639	35,903	(34.2)	37,566	65,553	(42.7)
Adjusted net income <sup>(3)</sup> per unit	0.19	0.29	(34.5)	0.31	0.54	(42.6)

- (1) The value of the CPA is amortized on a straight line basis over the life of the agreement. In the fourth quarter of 2009, Jazz changed its estimate of the useful life of this asset to coincide with the extended term of the CPA provided under the CPA Amending Agreement.
- (2) Beginning January 1, 2011 Jazz will become subject to income tax. The future tax recovery represents the change in the future liability during the period based on the changes of temporary differences during the period. (Refer to Section 12 - Critical Accounting Estimates for further detail.)
- (3) Adjusted net income equals net income before amortization of CPA Asset, and recovery of future income taxes. This is a non-GAAP measurement.



## 4. SECOND QUARTER ANALYSIS

---

The following discussion compares the results of operations of Jazz for the three months ended June 30, 2010 to the three months ended June 30, 2009.

### Operating Revenue

Operating revenue decreased from \$373.6 million to \$359.0 million in the second quarter of 2010, representing a decrease of 3.9%. This decrease in revenue was primarily attributable to a 4.9% reduction in Billable Block Hours, a 3.0% reduction in departures, a lower US dollar exchange rate, and a reduction in the mark-up charged by Jazz under the CPA, effective August 1, 2009 from 16.72% to 12.50% (refer to Section 10 - Economic Dependence for a description of such reduction); offset by rate increases made pursuant to the CPA and an increase in pass-through costs.

Other revenue earned from charter flights and other sources, such as groundhandling, decreased from \$2.4 million to \$2.3 million.

### Operating Expenses

Jazz's costs, under the CPA, fall into two principal categories: (i) pass-through costs, such as fuel, navigation, landing and terminal fees, rent on certain aircraft (effective August 1, 2009, refer to Section 10 - Economic Dependence) and other costs; and (ii) Controllable Costs such as salaries, wages and benefits, aircraft maintenance, materials and supplies, terminal handling services (with the exception of de-icing) and on certain aircraft rent, which are borne by Jazz, but in respect of which Jazz indirectly recovers amounts from Air Canada through the fees it charges Air Canada under the CPA.

Operating expenses decreased from \$336.9 million to \$332.1 million, a decrease of \$4.8 million or 1.4%.

- Salaries, wages and benefits decreased by \$0.3 million due to a decrease in Block Hours; offset by wage and scale increases under collective agreements.
- Aircraft fuel costs increased by \$9.3 million due to an increase of \$12.2 million in the cost of fuel; offset by a \$2.9 million decrease in fuel usage due to a reduction in the number of Block Hours.
- Depreciation and amortization expense decreased by \$0.5 million due to a change in the residual values for aircraft; offset by increased capital expenditures on aircraft rotatable parts and other equipment.
- Aircraft maintenance expense decreased by \$3.5 million as a result of: the effect of the decrease in the US dollar exchange rate on certain material purchases of \$2.1 million, and a decrease in Block Hours flown of \$2.0 million; offset by other maintenance costs of \$0.6 million.
- Airport and navigational fees decreased by \$1.4 million as a result of changes in aircraft deployment and a decrease in the number of departures; offset by a general rate increase.
- Aircraft rent decreased by \$5.1 million primarily as a result of a lower US dollar exchange rate, and new lease arrangements with respect to certain aircraft.
- Terminal handling costs decreased by \$0.1 million due to a reduction in the number of departures and changes in aircraft deployment which resulted in rate decreases.
- Other expenses decreased by \$2.9 million due to a decrease in general overhead expenses.

### Non-Operating Expenses

Non-operating expenses amounted to \$3.2 million, representing an increase of \$2.4 million. This change was primarily attributable to increased net interest expense related to the convertible debentures issued by Jazz in 2009 (refer to Section 8 - Liquidity and Capital Resources), a foreign exchange loss arising as a result of the change in value of the Canadian dollar relative to the US dollar, and a reduction in gain on disposal of property and equipment.



## 5. YEAR-TO-DATE ANALYSIS

---

The following is a discussion that compares the results of operations of Jazz for the six months ended June 30, 2010 to the six months ended June 30, 2009.

### Operating Revenue

Operating revenue decreased from \$743.0 million to \$714.4 million, representing a decrease of 3.9%. This decrease in revenue was primarily attributable to a 5.5% reduction in Billable Block Hours, a 2.8% reduction in departures, a lower US dollar exchange rate, and a reduction in the mark-up charged by Jazz under the CPA, effective August 1, 2009 from 16.72% to 12.50% (refer to Section 10 - Economic Dependence for a description of such reduction); offset by rate increases made pursuant to the CPA and an increase in pass-through costs.

Other revenue earned from charter flights and other sources such as groundhandling increased from \$4.4 million to \$4.6 million.

### Operating Expenses

Operating expenses decreased from \$674.7 million to \$670.7 million, a decrease of \$4.0 million or 0.6%.

- Salaries, wages and benefits increased by \$3.9 million due to wage and scale increases under collective agreements; offset by a decrease in Block Hours and a decrease in operational overtime.
- Aircraft fuel costs increased by \$17.7 million due to an increase of \$23.1 million in the cost of fuel; offset by a \$5.4 million decrease in fuel usage due to a reduction in the number of Block Hours.
- Depreciation and amortization expense increased by \$0.1 million due to increased capital expenditures on aircraft rotatable parts and other equipment; offset by a change in residual values for aircraft.
- Aircraft maintenance expense decreased by \$3.8 million as a result of: the effect of the decrease in the US dollar exchange rate on certain material purchases of \$4.9 million, and a decrease in Block Hours flown of \$3.4 million; offset by increased rates under new maintenance contracts of \$2.7 million, and other maintenance costs of \$1.8 million.
- Airport and navigational fees decreased by \$2.5 million arising as a result of changes in aircraft deployment and a decrease in departures; offset by a general rate increase.
- Aircraft rent decreased by \$12.7 million primarily as a result of a lower US dollar exchange rate, and new lease arrangements with respect to certain aircraft.
- Terminal handling costs decreased by \$2.9 million due to a reduction in the number of departures and changes in aircraft deployment which resulted in rate decreases.
- Other expenses decreased by \$3.2 million due to a decrease in general overhead expenses.

### Non-Operating Expenses

Non-operating expenses amounted to \$6.1 million, an increase of \$3.4 million. This change was mainly attributable to an increase in net interest expense relating to the convertible debentures issued by Jazz in 2009 (refer to Section 8 - Liquidity and Capital Resources), a foreign exchange loss arising as a result of the change in value of the Canadian dollar relative to the US dollar, and a reduction in gain on disposal of property and equipment.



## 6. PERFORMANCE INDICATORS

---

Jazz uses certain non-GAAP financial measures, described below, to evaluate operating performance, and in making decisions relating to distributions to unitholders. These measures are not recognized for financial statement presentation under Canadian GAAP, do not have a standardized meaning, and are therefore not likely to be comparable to similar measures presented by other public entities.

### **EBITDA**

EBITDA (earnings before interest, taxes, depreciation, amortization and obsolescence) is a non-GAAP financial measure commonly used throughout all industries to view operating results before interest expense, interest income, depreciation and amortization, gains and losses on property and equipment and other non-operating income and expense. Management believes EBITDA assists investors in comparing Jazz's performance on a consistent basis without regard to depreciation and amortization, which are non-cash in nature and can vary significantly depending on accounting methods and non-operating factors such as historical cost. EBITDA should not be used as an exclusive measure of cash flow because it does not account for the impact of working capital growth, capital expenditures, debt repayments and other sources and uses of cash, which are disclosed in the statements of cash flows.

### **Distributable Cash**

Distributable cash is a non-GAAP measure generally used by Canadian open-ended trusts as an indication of financial performance. It should not be seen as a measurement of liquidity or a substitute for comparable measurements prepared in accordance with GAAP. Distributable cash may differ from similar calculations as reported by other entities and, accordingly, may not be comparable to distributable cash as reported by such entities (refer to Section 17 - Risk Factors, Risks relating to the Structure of the Fund).

Jazz currently intends to make distributions to the holders of Units ("unitholders") (refer to Caution regarding forward-looking information on page 1 of this MD&A). Any such distributions will be made to unitholders of record on the last business day of each month, within 15 days of the end of each month, net of estimated cash amounts required for expenses and other obligations of Jazz, cash redemptions or repurchases of Units, and any tax liability. Declared distributions to the unitholders amounted to \$18.4 million and \$36.9 million for the three and six months ended June 30, 2010 (\$30.9 million and \$61.8 million for the three and six months ended June 30, 2009). Distributions are recorded when declared. Distributions are determined by the board of directors of Jazz GP, as general partner of the Partnership and by the Trustees of Jazz, based on performance and future cash requirements.

On July 28, 2009, the Trustees adjusted cash distributions in light of amendments made to the CPA in 2009 and to otherwise improve liquidity during an uncertain period. Effective with the distribution payment paid in September 2009 to unitholders of record on August 31, 2009, the Trustees resolved to reduce cash distributions by approximately 40% to \$0.60 per Unit annually. The actual amount distributed in respect of the Units is not guaranteed and depends upon numerous factors, including Jazz's profitability and its ability to sustain operating cash flows and the fluctuations in Jazz's working capital and capital expenditures and refinancing of debt obligations, all of which are susceptible to a number of risks. (Refer to Section 17 - Risk Factors.)



## Standardized Distributable Cash

Standardized distributable cash is a non-GAAP measure recommended by the CICA in order to provide a consistent and comparable measurement of distributable cash across entities.

Standardized distributable cash is defined as cash flows from operating activities, as reported in accordance with GAAP, less adjustments for:

- total capital expenditures as reported in accordance with GAAP; and
- restrictions on distributions arising from compliance with financial covenants applicable at the date of the calculation of standardized distributable cash.

The following table provides a reconciliation of EBITDA and distributable cash of Jazz to operating income:

(expressed in thousands of Canadian dollars) (unaudited)	Three months ended June 30,		Six months ended June 30,	
	2010 \$	2009 \$	2010 \$	2009 \$
Operating income	18,825	26,189	27,604	47,275
Depreciation and amortization <sup>(1)</sup>	15,148	18,089	31,173	36,074
EBITDA	33,973	44,278	58,777	83,349
EBITDA margin (%) <sup>(2)</sup>	9.5	11.9	8.2	11.2
EBITDA	33,973	44,278	58,777	83,349
Non-operating expenses	(3,234)	(811)	(6,134)	(2,772)
Maintenance Capital Expenditures <sup>(3)</sup>	(1,916)	(2,848)	(5,304)	(5,969)
Distributable cash	28,823	40,619	47,339	74,608

(1) Includes depreciation and amortization of property and equipment and amortization of CPA Asset.

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

(3) Refer to Section 8 - Liquidity and Capital Resources for further discussion.



Reconciliation of cash flows from operating activities to standardized distributable cash and distributable cash is as follows:

(expressed in thousands of Canadian dollars) (unaudited)	Three months ended June 30,		Six months ended June 30,	
	2010 \$	2009 \$	2010 \$	2009 \$
Cash flows from operating activities	28,019	23,918	47,098	54,282
Maintenance capital expenditures, net of gain on disposal	(1,767)	(2,271)	(4,820)	(4,784)
Standardized distributable cash	26,252	21,647	42,278	49,498
Change in non-cash operating working capital <sup>(1)</sup>	5,360	18,934	9,174	23,851
Amortization of prepaid aircraft rent and related fees <sup>(1)</sup>	(465)	(483)	(934)	(965)
Unit based compensation <sup>(1)</sup>	(550)	(479)	(1,100)	(958)
Funding of unit based compensation, net of forfeitures <sup>(1)</sup>	-	(201)	(127)	2,044
Accretion of debt component of convertible debentures	(150)	-	(319)	-
Foreign exchange gain (loss) <sup>(1)</sup>	(734)	1,684	(201)	936
Other <sup>(1)</sup>	(890)	(483)	(1,432)	202
Distributable cash	28,823	40,619	47,339	74,608
Distributions declared	18,429	30,888	36,858	61,776
Payout ratio - distributions declared/ standardized distributable cash	70.2%	142.7%	87.2%	124.8%
Payout ratio - distributions declared/ distributable cash	63.9%	76.0%	77.9%	82.8%

**Cumulative - since IPO<sup>(2)</sup>**

Standardized distributable cash	594,448	483,060
Distributable cash	608,514	496,517
Distributions declared	484,958	407,089
Standardized distributable cash payout ratio	81.6%	84.3%
Distributable cash payout ratio	79.7%	82.0%

(1) These items are adjustments made in reference to the definition of distributable cash in the limited partnership agreement of Jazz and relate to timing differences.

(2) The period covered is from February 2, 2006, the IPO date (amounts for 2006 and 2007 are those of the Partnership).



The following table provides disclosure regarding the relationship between cash flows from operating activities and net income, and historical distributed cash amounts.

(expressed in thousands of Canadian dollars) (unaudited)	Three months ended June 30, 2010 \$	Six months ended June 30, 2010 \$	Year ended December 31, 2009 \$	Year ended December 31, 2008 \$
Cash flows from operating activities	28,019	47,098	130,089	155,088
Adjusted net income <sup>(1)</sup>	23,639	37,566	121,994	134,936
Cash distributions declared relating to the period	18,429	36,858	102,787	123,552
Excess of cash flows from operating activities over cash distributions declared	9,590	10,240	27,302	31,536
Excess of adjusted net income <sup>(1)</sup> over cash distributions declared	5,210	708	19,207	11,384
Payout ratios				
Distributions declared/cash flows from operating activities	<i>65.8%</i>	<i>78.3%</i>	<i>79.0%</i>	<i>79.7%</i>
Distributions declared/adjusted net income <sup>(1)</sup>	<i>78.0%</i>	<i>98.1%</i>	<i>84.3%</i>	<i>91.6%</i>

(1) Adjusted net income equals net income before amortization of CPA Asset, recovery of future income taxes, and, in 2008 a goodwill impairment loss. This is a non-GAAP measurement.



## 7. QUARTERLY FINANCIAL DATA

The table below describes quarterly financial results, as well as major operating statistics, of Jazz:

(unaudited)	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008
Operating revenue (\$000)	359,010	355,372	351,238	379,659	373,569	369,434	392,684	437,439
Operating expenses (\$000)	332,137	338,545	325,932	344,893	336,855	337,823	352,957	392,069
Amortization of CPA Asset (\$000)	8,048	8,048	8,048	10,525	10,525	10,525	10,525	10,525
Operating income (\$000)	18,825	8,779	17,258	24,241	26,189	21,086	29,202	34,845
Total non-operating expense (\$000)	3,234	2,900	2,111	1,520	811	1,961	158,017 <sup>(1)</sup>	3,096
Net income (loss) (\$000)	15,591	6,523	20,816	25,321	25,378	21,123	(86,493)	31,749
Adjusted net income <sup>(2)</sup> (\$000)	23,639	13,927	23,195	33,246	35,903	29,650	34,940	42,274
Billable Block Hours	93,585	89,745	91,783	100,486	98,410	95,541	98,232	106,325
Available Seat Miles (000's)	1,345,703	1,233,156	1,265,084	1,449,292	1,408,433	1,269,475	1,319,052	1,502,652
Cost per Available Seat Mile (CASM) (¢)	24.68	27.45	25.76	23.80	23.92	26.61	26.76	26.09
CASM, excluding fuel expense (¢)	19.38	22.12	20.65	18.85	19.51	22.09	19.98	17.29
EBITDA (\$000)	33,973	24,804	33,261	42,476	44,278	39,071	47,604	52,789
Distributable cash (\$000)	28,823	18,516	26,743	37,915	40,619	33,989	37,418	44,295
Distributable cash per unit (\$)	0.24	0.15	0.22	0.31	0.33	0.28	0.31	0.36
Distributions declared per unit (\$)	0.15	0.15	0.15	0.19	0.25	0.25	0.25	0.25
Net income (loss) per unit, basic and diluted (\$)	0.13	0.05	0.17	0.21	0.21	0.17	(0.71)	0.26
Adjusted net income <sup>(2)</sup> per unit, basic (\$)	0.19	0.11	0.19	0.27	0.29	0.24	0.29	0.35

(1) Includes a goodwill impairment loss of \$153.2 million.

(2) Adjusted net income equals net income before amortization of CPA Asset, recovery of future income taxes, and in Q4 2008 a goodwill impairment loss. This is a non-GAAP measurement.

## 8. LIQUIDITY AND CAPITAL RESOURCES

Jazz continues to generate positive operating income and cash flows from operations. At June 30, 2010, Jazz had \$76.5 million in cash and cash equivalents on hand, representing a decrease of \$147.0 million or 65.8% from December 31, 2009 (refer to discussion below on repayment of long-term debt). Jazz expects to be able to generate sufficient cash flow to fund cash distributions (which are declared at the discretion of the Board), planned capital expenditures and service convertible debentures. (Refer to Caution regarding forward-looking information on page 1 of this MD&A.) Management has evaluated aspects of Jazz's business and financial condition and, as at the date of this report, no material adverse changes with respect to its liquidity have occurred. (Refer to Section 17 - Risk Factors, and to Caution regarding forward-looking information on page 1 of this MD&A.)



## Summary of Cash Flows

The following table provides an overview of Jazz's cash flows for the periods indicated:

(expressed in thousands of Canadian dollars) (unaudited)	Three months ended June 30,		Six months ended June 30,	
	2010 \$	2009 \$	2010 \$	2009 \$
Cash provided by operating activities	28,019	23,918	47,098	54,282
Cash used in financing activities	(19,079)	(31,563)	(153,295)	(63,155)
Cash used in investing activities	(37,762)	(2,271)	(40,815)	(4,365)
Net change in cash and cash equivalents during the periods	(28,822)	(9,916)	(147,012)	(13,238)
Cash and cash equivalents - Beginning of periods	105,369	128,554	223,559	131,876
Cash and cash equivalents - End of periods	76,547	118,638	76,547	118,638

### Operating activities

Jazz continued to generate positive cash flows from operations of \$28.0 million and \$47.1 million for the three and six months ended June 30, 2010, compared to \$23.9 million and \$54.3 million for the same periods in 2009; related to a decrease in accounts payable and accrued liabilities and a lower net income; offset by a decrease in accounts receivable and spare parts, materials and supplies.

### Financing activities

Cash used in financing activities for the three and six months ended June 30, 2010 included distributions to unitholders of Jazz of \$18.4 million and \$36.9 million, respectively, a repayment of obligations under capital leases of \$0.7 million and \$1.3 million respectively, and a repayment of long-term debt of \$115.0 million. Cash used in financing activities for the three and six months ended June 30, 2009 included distributions to unitholders of Jazz of \$30.9 million and \$61.8 million, respectively, and a repayment of obligations under capital leases of \$0.7 million and \$1.4 million, respectively.

### Investing activities

Investing activities for the three and six months ended June 30, 2010 included capital expenditures of \$1.9 million and \$5.3 million, respectively, compared to \$2.8 million and \$6.0 million, respectively, for the same periods in 2009, a \$16.4 million investment in LARAH, and \$19.6 million in purchase deposits on aircraft, including other costs, relating to the order of Q400 NextGen turboprop aircraft. Capital expenditures consisted of investments made to replenish aircraft rotatable parts and other purchases necessary to support the ongoing operations.

### Contractual obligations and other commitments

Please refer to the Fund's annual MD&A dated February 9, 2010 for information regarding Jazz's contractual obligations and other commitments. There have been no material changes during the three and six months ended June 30, 2010, with the exception of the long-term debt repayment of \$115.0 million and the Bombardier aircraft purchase agreement, as discussed below.

Based on the list price for the Q400 NextGen aircraft, the firm order is valued at approximately US\$454.0 million and could increase to US\$937.0 million if the option to purchase an additional 15 aircraft is exercised. Subject to satisfaction of customary conditions, aircraft deliveries are scheduled to commence in May 2011. The purchase agreement requires on-going monthly predelivery payments in the aggregate amount of \$34.7 million, until July 2011. As at June 30, 2010, Jazz had made all required payments.



Jazz has received financing commitments from a third party lender for all firm orders covering up to 85% of the net purchase price.

In 2007 and 2010, Jazz entered into common terms agreements (“CTAs”) which govern three of Jazz’s aircraft leases and which will also apply to any future aircraft leases with the same lessors. Jazz was in compliance with the tangible asset disposal covenants, contained in these CTAs, as at June 30, 2010.

#### **Long-term debt**

The Credit Facilities matured on February 1, 2010 and all amounts owing thereunder were repaid and the related security was released. As a result, excluding \$3.5 million in cash encumbered in support of issued letters of credit, Jazz has all of its assets unencumbered and available to support future debt financing. Jazz has sufficient liquidity to operate its business after such repayment, which was funded out of cash and cash equivalents with a payment of \$115.0 million.

#### **Convertible debentures**

The convertible debentures issued by Jazz bear interest at a rate of 9.50% per annum payable semi-annually in arrears on June 30 and December 31 in each year commencing on June 30, 2010, and will mature on December 31, 2014 (the “Maturity Date”). The debentures are convertible at the holder’s option into Units of Jazz at any time prior to 5:00 pm (EST), on the earlier of the Maturity Date and the date fixed for redemption at a conversion price of \$5.25 per Unit. The debentures are not redeemable on or before December 31, 2012, except upon a change of control or default. After December 31, 2012 and prior to December 31, 2013, the debentures may be redeemed in whole or in part from time to time at Jazz’s option at a price equal to their principal amount plus accrued interest, provided that the volume weighted average trading price for the Units is not less than 125% of the conversion price. On and after December 31, 2013 and prior to the Maturity Date, the debentures may be redeemed in whole or in part from time to time at Jazz’s option at a price equal to their principal amount plus accrued interest. Subject to regulatory approval, Jazz may satisfy its obligation to repay the principal amount of the debentures on redemption or at maturity, in whole or in part, by delivering that number of Units equal to the amount due divided by 95% of the market price for the Units at that time, plus accrued interest in cash. Proceeds from the offering are being used for working capital requirements and for general purposes of Jazz. On June 30, 2010, Jazz made its first interest payment to the holders of the convertible debentures in the amount of \$5.2 million.

#### **Units**

As at June 30, 2010 and August 3, 2010, Jazz had 122,864,012 Units issued and outstanding. The convertible debentures are convertible for an aggregate of 16,428,571 Units. If all of the convertible debentures are exercised, Jazz would have 139,292,483 Units outstanding.

## **9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

---

Jazz’s financial instruments consist of cash and cash equivalents, accounts receivable, asset backed commercial paper (“ABCP”), accounts payable and accrued liabilities, obligations under capital leases, long-term debt, convertible debentures and its investment in LARAH.

Jazz has exposure to the following risks from its use of financial instruments: interest rate risk, credit risk, liquidity risk and currency risk. Senior management monitors risk levels and reviews risk management activities as they determine to be necessary.

#### **Interest rate risk**

Investments included in Jazz’s cash and cash equivalents earn interest at prevailing and fluctuating market rates, as Jazz’s objective is to maintain these balances in highly liquid investments. As at June 30, 2010, Jazz’s investments consisted of bankers acceptances and bankers deposit notes issued by two Schedule 1 banks.

#### **Credit risk**

In accordance with its investment policy, Jazz invests excess cash in Government of Canada treasury bills, short-term Canadian and provincial government debt, bankers’ acceptance notes, term deposits of Schedule 1 banks and



Schedule 2 banks rated R-1 high, and commercial paper rated R-1 high. Jazz manages the credit risk in respect of these investments by ensuring that the counter-parties are governments, banks and corporations with high credit-ratings assigned by international credit-rating agencies. Given the disruption in the third party sponsored ABCP market, Jazz amended its investment policy to prohibit investment in all third party and bank sponsored ABCP.

The amount of accounts receivable disclosed on the balance sheet of \$59.2 million is net of allowances for bad debts, estimated by management based on prior experience and its assessment of the current economic environment and the specific debtor. Approximately \$55.4 million of such receivables are with one company, Air Canada. Accordingly, Jazz is directly affected by the financial and operational strength of Air Canada (refer to Section 17 - Risk Factors). Jazz does not believe it is subject to any significant concentration of credit risk other than with Air Canada.

### **Liquidity risk**

Jazz's objective is to maintain sufficient liquidity to meet liabilities when due. Jazz monitors its cash balances and cash flows generated from operations to meet its liquidity requirements. The Credit Facilities matured on February 1, 2010 and all amounts owing thereunder were repaid. Jazz has sufficient liquidity to operate its business after such repayment, which was funded out of cash and cash equivalents with a payment of \$115.0 million. The letters of credit remain outstanding and have been cash collateralized. Letters of credit were issued as security for groundhandling and airport fee contracts, lease payments on rental space and aircraft, and certain employee benefits.

Jazz has a minority, non-voting interest in LARAH which is a private company. Jazz has no control over the timing of a liquidity event (such as an IPO or permitted sale). There is a risk that Jazz will not be able to realize on its investment in LARAH within a reasonable time frame. Jazz has no commitment to make any further investment in LARAH.

### **Currency risk**

Jazz receives revenue and incurs expenses in US and Canadian currency, and as such, is subject to foreign currency exchange rate risk. Jazz manages its exposure to currency risk by billing for services rendered under the CPA in the underlying currency of the related expenditure. Accordingly, the primary exposure results from balance sheet fluctuations of US denominated cash, accounts receivable, accounts payable, and, in particular, obligations under capital leases, which are long-term and therefore subject to larger unrealized gains or losses. Jazz seeks to minimize its currency risk by maintaining a balance of US dollars used to pay US denominated liabilities and by replenishing the balance with inflows arising from US dollar denominated revenues. As at June 30, 2010, the amount of US dollar denominated assets owned by Jazz was \$35.1 million and US denominated liabilities owed by Jazz was \$59.6 million. A 1¢ change in the US exchange rate would result in a change in the unrealized gain or loss of approximately \$0.2 million.

## **10. ECONOMIC DEPENDENCE**

---

### **The CPA**

The CPA consists of a number of variable components based on certain different metrics, including Block Hours flown, flight hours, cycles (number of take-offs and landings), number of passengers and number of Covered Aircraft. The rates for these metrics are fixed for annual periods and vary by aircraft type. In addition, Air Canada is required to reimburse Jazz for certain pass-through costs, including fuel, de-icing, navigation, landing and terminal fees, station provisioning costs, station termination costs, passenger liability insurance and certain employee relocation costs. Since these costs are required to operate the Covered Aircraft, the reimbursement of these costs is included in Jazz's revenue. Jazz is also paid certain performance incentive payments on a quarterly basis related to on-time performance, controllable flight completion, baggage handling performance and other customer satisfaction criteria.

Jazz and Air Canada agreed to re-set detailed rates applicable to the period commencing on January 1, 2009 and ending on December 31, 2011. During the first quarter of 2009, Jazz reached an agreement with Air Canada regarding the establishment of new rates for Controllable Costs that are payable by Air Canada under the CPA in the following three-year period (2009 to 2011, inclusive). The new rates which were retroactive to January 1, 2009, apply a 16.72% mark-up on Jazz's Controllable Costs for each of the years 2009 to 2011 (for the years 2006 to 2008 the percentage mark-up was 16.40%).



## Amendments to the CPA

On July 28, 2009, Jazz and Air Canada agreed to amend the terms of the CPA in response to uncertainty in the airline industry and Air Canada's need to implement cost reduction initiatives. On September 22, 2009 Jazz and Air Canada executed the CPA Amending Agreement to document certain amendments to the CPA, including those amendments described below.

The CPA Amending Agreement extends the initial term of the CPA from December 31, 2015 to December 31, 2020 and provides greater certainty regarding the number of annual Block Hours to be scheduled for flying by Jazz. Under the CPA Amending Agreement, Air Canada agreed to use reasonable commercial efforts to provide a minimum of 375,000 total annual Block Hours to Jazz, as measured by the sum of the twelve monthly schedules delivered by Air Canada to Jazz for a calendar year (the "Annual Delivered Block Hours"). In addition, Air Canada and Jazz agreed that the minimum average daily utilization per aircraft, as stated in Block Hours, will not result in less than 339,000 annual Block Hours (the minimum average daily utilization guarantee or "MADUG"), notwithstanding the temporary reduction in the number of Covered Aircraft to 123 aircraft and the subsequent permanent reduction in the number of Covered Aircraft to 125, subject to Air Canada's one-time right to revise the MADUG in the circumstances described below.

In addition to establishing the annual minimum number of Block Hours on which the MADUG is based, the CPA Amending Agreement provides Air Canada with the right to revise the MADUG effective in January 2016 in the event Air Canada's domestic market share for the twelve month period from October 1, 2014 to September 30, 2015 has decreased by a fixed percentage compared to its domestic market share for the twelve month period from August 1, 2008 to July 31, 2009. In the event of such a decrease, the CPA Amending Agreement requires that Air Canada and Jazz agree to a revised MADUG by November 17, 2015, failing which Air Canada shall have the right to unilaterally set a revised MADUG by sending Jazz notice by November 20, 2015. The CPA Amending Agreement provides Jazz with the right to send Air Canada notice by December 18, 2015 of its intention to either accept the revised MADUG or exercise its right to terminate the CPA as of December 31, 2016.

The CPA Amending Agreement also amended the rates established for the rate period commencing January 1, 2009 and ending on December 31, 2011 (the "2009-2011 Rate Period"). The rates negotiated provide a mark-up of 16.72% on Jazz's Controllable Costs. However, pursuant to the terms of the CPA Amending Agreement, Air Canada and Jazz agreed that the Controllable Mark-Up of 16.72% shall only apply as of and from January 1, 2009 through to July 31, 2009. Effective August 1, 2009, an agreed set of revised rates became effective, under which Jazz applies a Controllable Mark-Up of 12.50% on Jazz's Controllable Costs.

Following the expiration of the 2009-2011 Rate Period, the CPA Amending Agreement established the following three remaining rate periods during the initial term of the CPA: (i) January 1, 2012 to December 31, 2014; (ii) January 1, 2015 to December 31, 2017 and; (iii) January 1, 2018 to December 31, 2020. Prior to the commencement of each rate period Jazz and Air Canada shall determine the rates to be charged by Jazz during each period (applying a rate reset process set out in the CPA). The CPA provides that Air Canada and Jazz will review and agree in writing on the rates for the next rate period. The components of each rate to be considered in this process are set out in the schedules to the CPA and are based on costs forecasted by Jazz. If Jazz and Air Canada cannot agree on new rates, the matter is subject to the arbitration provisions in the CPA.

The CPA Amending Agreement also provides for adjustments to the Controllable Mark-Up in certain circumstances. Commencing January 1, 2010, if the Annual Delivered Block Hours are less than 375,000 Block Hours, the Controllable Mark-Up will be increased, to a maximum of 16.72%, to compensate Jazz for increased unit costs and margin lost due to the reduction in flying. If, on the other hand, the Annual Delivered Block Hours are greater than 375,000 Block Hours, then the Controllable Mark-Up of 12.50% will only apply to Jazz's fixed controllable charges and the Controllable Mark-Up of 12.50% shall be reduced to 5% on Jazz's variable controllable charges for Block Hours in excess of 375,000.

The Controllable Mark-Up may also be reduced as a result of benchmarking Jazz's Controllable Costs to those of a group of comparable operators (the "Comparator Group") in 2010 and 2016. Jazz and Air Canada agreed to compare and benchmark Jazz's Controllable Costs to those of the Comparator Group in 2010 for the 2009 calendar year (the "2009 Benchmark"). Pursuant to the terms of the CPA Amending Agreement, Jazz and Air Canada agreed to a second benchmarking in 2016 for the 2015 calendar year (the "2015 Benchmark"). If the 2009 Benchmark indicates that the percentage difference between Jazz's Controllable Costs and those of the Comparable Group has increased compared to the percentage difference for the twelve month period beginning July 1, 2006 and ending June 30, 2007, then the Controllable Mark-Up will be reduced with effect as of January 1, 2010 until December 31, 2020, unless as a result of the 2015 Benchmark it is further reduced, to the lower of 12.50% or the percentage that is equal to 16.72% minus the amount



of the increase described above. If the 2015 Benchmark indicates that the percentage difference between Jazz's Controllable Costs and those of the Comparable Group has increased compared to the percentage difference determined during the 2009 benchmarking, the Controllable Mark-Up then in effect shall be reduced based on the results of the 2015 Benchmark, with effect as of January 1, 2016 until December 31, 2020.

The CPA Amending Agreement provides for changes to the long range fleet plan, reflecting the agreement of Air Canada and Jazz to renew the fleet of Covered Aircraft. Air Canada and Jazz agreed that the fleet of Covered Aircraft shall be reduced from 133 aircraft to a guaranteed minimum number of 125 aircraft (the "Guaranteed Minimum Number of Covered Aircraft"). The reduction in Covered Aircraft to the Guaranteed Minimum Number of Covered Aircraft has commenced. (Refer to Section 14 - Fleet for further discussion.)

On April 30, 2010, Jazz signed a purchase agreement with Bombardier regarding an order for 15 Q400 NextGen turboprop aircraft. It is expected that one aircraft will be delivered per month commencing in May 2011. (Refer to Section 1 - Overview for further discussion.) Jazz and Air Canada have agreed to use commercially reasonable efforts to agree to the rates to be charged for the new turboprop aircraft prior to their delivery, failing which the matter shall be determined in accordance with the dispute resolution provisions in the CPA. Following the delivery of the second new turboprop aircraft in June 2011, the number of aircraft comprising the Covered Aircraft will return to the Guaranteed Minimum Number of Covered Aircraft and two of the CRJ-100 aircraft may be treated as unassigned aircraft for scheduling purposes.

Upon the arrival of each remaining turboprop aircraft, one CRJ-100 or CRJ-200 will be removed from the fleet of Covered Aircraft and replaced with one arriving turboprop aircraft, such that the number of aircraft shall remain at the Guaranteed Minimum Number of Covered Aircraft. Upon the removal of the twelfth CRJ-100 or CRJ-200 aircraft, Air Canada and Jazz shall use commercially reasonable efforts to agree to new rates for this aircraft type. Pursuant to the terms of the CPA Amending Agreement, Air Canada has agreed to pay the costs associated with the removal of the CRJ-100 and CRJ-200 aircraft from the fleet of Covered Aircraft.

Pursuant to the terms of the CPA Amending Agreement, Air Canada and Jazz also agreed, effective as of August 1, 2009, to treat the rent charged to Jazz for three of the CRJ-100 aircraft as a pass-through cost. Jazz and Air Canada have also agreed to use commercially reasonable efforts to agree by March 31, 2010 to terms and conditions relating to deploying up to eight CRJ-100 aircraft ("Swing Aircraft"). Jazz and Air Canada are currently discussing the applicable terms and conditions and have agreed to extend the deadline for their agreement to December 31, 2010. If an agreement is reached, Air Canada may commence the use of such Swing Aircraft to operate Scheduled Flights in 2011, following the delivery of a third new turboprop aircraft to Jazz. If Jazz and Air Canada cannot agree on terms and conditions relating to the deployment of Swing Aircraft, the matter is subject to the arbitration provisions in the CPA. The rent to be charged for the Swing Aircraft shall also be treated as a pass-through cost. All or some of these Swing Aircraft may be removed from Jazz's fleet by Air Canada. The Swing Aircraft in Jazz's fleet from time to time, if any, are in addition to the Guaranteed Minimum Number of Covered Aircraft.

### **Master Services Agreement**

Under the Master Services Agreement dated September 24, 2004, between Jazz and Air Canada, Air Canada provides certain services to Jazz for a fee. These services include Insurance and Tax Services, Corporate Real Estate Services, Environmental Affairs Services and Legal Services.

The Master Services Agreement will continue in effect until the termination or expiration of the CPA, but individual services can be terminated earlier in accordance with the terms of the Master Services Agreement.

### **Other**

Air Canada provides certain supplies from third parties, primarily fuel, to Jazz and subsequently collects payment from Jazz. As these transactions and balances merely represent a method of settlement for transactions in the normal course of business, they have not been separately disclosed. Air Canada ground handling services (formerly ACGHS Limited Partnership) a division of Air Canada provides ground handling services.

Substantially all of the trade receivable from Air Canada relates to outstanding balances under the CPA.

The balances in accounts payable and accrued liabilities are payable on normal trade terms and have arisen from the services provided by the applicable party.



Jazz has a significant amount of transactions with Air Canada and its subsidiaries. Air Canada and its subsidiaries represented 99.3% of Jazz's operating revenues for the three months ended June 30, 2010 (99.3% for the three months ended June 30, 2009). Approximately 13.0% and 14.3% of Jazz's operating expenses for the three months ended June 30, 2010 and 2009, respectively, were incurred with Air Canada and its subsidiaries.

## 11. PENSION PLANS

### Projected pension funding obligations

The table below provides projections for Jazz's pension funding obligations from 2010 to 2014:

(expressed in thousands of Canadian dollars)	2010 \$	2011 \$	2012 \$	2013 \$	2014 \$
Defined benefit pension plans, current service	13,000	16,600	17,100	17,500	18,200
Defined benefit pension plans, past service	7,700	5,600	6,000	6,000	5,600
Defined contribution pension plans	8,000	8,400	8,700	9,100	9,400
Projected pension funding obligations	28,700	30,600	31,800	32,600	33,200

The estimated pension funding obligations shown in the above table are in respect of the defined benefit and defined contribution pension plans sponsored by Jazz. Defined benefit pension plans include the Jazz pilots' registered defined benefit pension plan as well as an unregistered defined benefit supplemental executive retirement plan that Jazz sponsors for eligible employees. Defined contribution pension plans include a number of defined contribution pension arrangements that Jazz contributes to for its eligible employees.

The funding requirements for the Jazz pilots' registered pension plan are estimated based on the January 1, 2010 actuarial valuation for that plan and an estimate of the pilot payroll over the projection period. The estimated funding requirements for the supplemental executive retirement plan are based on a funding policy adopted by Jazz and the January 1, 2010 actuarial valuation for that plan.

The January 1, 2010 actuarial valuation for the Jazz pilot's registered plan uses a smoothed value of the plan asset which amortizes investment gains and losses over a five year period with a cap on the smoothed value of assets at 110% of market value of assets.

The pension funding projections also include estimates for pension plan changes recently negotiated with the pilots and flight attendants unions.

Changes in the economic conditions, mainly the investment returns generated by the plan assets and changes in interest rates, will impact the financial position of these plans and, hence, future required contributions. These projections are updated annually (refer to Caution regarding forward-looking information on page 1 of this MD&A.)

## 12. CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with GAAP requires management to make estimates, judgments and assumptions that management believes are reasonable based upon the information available. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results can differ from those estimates (refer to Caution regarding forward-looking information on page 1 of this MD&A). The significant accounting policies of Jazz are described in note 2 of the June 30, 2010 unaudited consolidated financial statements of Jazz Air Income Fund. There were no material changes in the nature of critical accounting estimates during the three and six months ended June 30, 2010 from those disclosed in the Fund's annual MD&A for the year ended December 31, 2009.

## 13. ACCOUNTING POLICY CHANGES AND DEVELOPMENTS

---

### New accounting policies

#### *Available for sale financial instruments*

Available-for-sale assets are non-derivative financial assets that are either designated in this category or not classified in any of the other categories. Financial assets classified as available-for-sale are carried at fair value with the changes in fair value recorded in other comprehensive income, except for investments in equity instruments that do not have a quoted market price in an active market which should be measured at cost. Transaction costs incurred to acquire available-for-sale financial instruments are included in the underlying balance. When a decline in fair value is determined to be other-than-temporary, the cumulative loss included in accumulated other comprehensive income is removed and recognized in net income. Gains and losses realized on disposal of available-for-sale securities are recognized in net income. Jazz's investment in LARAH has been classified at available for sale and measured at cost as there is no quoted price in an active market.

LARAH and its subsidiaries are private companies with no quoted market price in an active market. Therefore the investment is recorded at cost and no fair value has been disclosed. Transaction costs of \$1.2 million deemed to be directly attributable to the acquisition of the LARAH shares have been included in the cost of the investment.

### Future accounting changes

#### *Convergence with International Financial Reporting Standards ("IFRS")*

In January 2006, the Canadian Accounting Standards Board ("AcSB") announced its decision to replace Canadian GAAP with IFRS. On February 13, 2008 the AcSB confirmed January 1, 2011 as the mandatory changeover date to IFRS for all Canadian publicly accountable enterprises. This means that the Fund will be required to prepare IFRS financial statements for the interim periods and fiscal year ends beginning in 2011. The Fund has created an implementation team, which consists of internal resources and an external consultant. A changeover plan is being established to convert to the new standards within the allotted timeline and consist of the following phases:

- Raise awareness and initial assessment - this phase involves performing a high level impact assessment to identify key IFRS areas that are likely to affect the Fund. Each accounting standard is reviewed under IFRS and is ranked as high, medium or low priority based on the differences from Canadian GAAP. Also, all relevant employees and board members are made aware of the changeover and the relevant timelines. The Fund completed this phase in the third quarter of 2008.
- Detailed assessment - each section is reviewed and analyzed for accounting or disclosure differences between Canadian GAAP and IFRS. Once differences have been identified they are reviewed for potential impacts to existing accounting policies, information systems and business processes. An action plan is then developed for each impact area. This phase is substantially complete.
- Implementation and review - the action plan developed in the detailed assessment phase is implemented to create, as necessary, new accounts, system changes, process changes and financial statement models. Accounting policies are approved, including transition elections in IFRS 1 (First time adoption of IFRS). This phase is currently underway.

Based on the in-depth analysis performed, the major differences between Canadian GAAP and IFRS that are likely to impact the Fund include, but are not limited to:

- IFRS 1 - provides entities with a number of optional and mandatory exemptions upon initial adoption of the standards. The exemption choices are being analyzed and the Fund will implement those determined to be most appropriate.
- Property, plant and equipment - International Accounting Standards ("IAS") 16 requires significant maintenance events to be broken out as a component of the initial cost and depreciated over the life of the maintenance event. The cost of the maintenance event will then be re-capitalized and this cycle will continue over the life of the asset.



- Impairment of assets - IAS 36 uses a one step approach for both testing and measurement of impairment, with assets' carrying values compared directly with the higher of fair value less costs to sell or value in use (which uses discounted cash flows). This could result in the impairment of the CPA asset on transition to IFRS.
- Recognition of leases - unlike Canadian GAAP, IAS 17 does not provide prescriptive measurements on lease contracts. As a result, all lease contracts are being reviewed to determine if they are operating or capital leases based on whether or not management feels substantially all of the risks and rewards incidental to ownership have been transferred.
- Accounting for defined benefit pension plans and other future employee benefits - IAS 19 requires the past service costs of defined benefit plans to be recognized on an accelerated basis with vested past service costs expensed immediately and unvested past service costs recognized on a straight line basis until the benefits become vested. Under Canadian GAAP, past service costs are generally amortized on a straight line basis over the average remaining service period. In addition, actuarial gains and losses are permitted to be recognized directly through equity under IAS 19 rather than through the income statement. For other future employee benefits, all actuarial gains and losses, as well as all past service costs, must be recognized immediately with no amortization option.

In addition to the sections noted above, there are generally more extensive presentation and disclosure requirements under IFRS compared to Canadian GAAP. These have been noted in the detailed analysis and are being added to draft IFRS financial statements. At this time, the quantitative effects on the financial statements cannot be reasonably estimated.

The following table outlines the key activities of the IFRS transition plan and the status of each of those activities:

	Key activities	Status
Financial Statement Preparation	Identify differences in Canadian GAAP/IFRS accounting policies Select IFRS policies Select transition options (IFRS 1) Create draft IFRS statements	The diagnostic phase of GAAP/IFRS differences was completed in the third quarter of 2008.  Draft IFRS statements are being developed and continue to be updated with changes to the Jazz business and changes to IFRS standards.  Jazz will continue to progress toward quantification of identified differences throughout 2010.
Training	Introduce an appropriate level of knowledge to the finance group, and the board of directors	All members of the finance group that are affected by changes to process have been part of the development of the new IFRS process and have been trained on the relevant differences in the standards.  The board of directors and senior management have received IFRS presentations keeping them updated on the potential changes to affect Jazz and training as to how and why those changes are taking place.  Operational staff have been updated on any changes that will affect their job as a result of IFRS.



	Key activities	Status
Information Technology (IT) Infrastructure	Identify any required updates or modifications to the IT systems.	Jazz has analyzed all required information under IFRS and does not believe any changes to its IT infrastructure will be necessary to facilitate the change-over.
Control Environment	For all accounting process changes, assess control design and effectiveness implementation of internal controls over financial reporting ("ICFR").	All identified material changes to ICFR have been assessed and tested by the internal audit department.
Business activities	Identification of impact of IFRS changes on compensation packages	The compensation packages are being assessed and revamped to address any changes to financial statement indicators and non-GAAP financial measures as a result of the adoption of IFRS as well as Jazz's anticipated changeover to a corporate structure.

*Business Combinations, Consolidated Financial Statements and Non-controlling Interests*

In January 2009, the CICA issued Section 1582, "Business Combinations", Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-controlling Interests" which replace Section 1581, "Business Combinations" and Section 1600, "Consolidated Financial Statements". Section 1582 establishes standards for the accounting for business combinations that is equivalent to the business combination accounting standard under IFRS. Section 1582 is applicable for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Early adoption of this section is permitted. Section 1601 together with Section 1602 establishes standards for the preparation of consolidated financial statements. Section 1601 is applicable for the entity's interim and annual consolidated financial statements for fiscal years beginning on or after January 1, 2011. Early adoption of this section is permitted. If the entity chooses to early adopt any one of these sections, the other two sections must also be adopted at the same time.

## 14. FLEET

As at June 30, 2010, Jazz's operating fleet was made up of 128 operating aircraft, of which 64 were regional jets and 64 turboprop aircraft.

Jazz's operating fleet, at June 30, 2010, was as described below:

(unaudited)	Number of Operating Aircraft	Average Age of Operating Aircraft	Owned	Capital Lease	Operating Lease	Number of Operating Aircraft June 30, 2009
Canadair Regional Jet CRJ-100	22	14.8	-	-	22	24
Canadair Regional Jet CRJ-200	26	8.0	-	-	26	33
Canadair Regional Jet CRJ-705	16	4.9	-	-	16	16
De Havilland DHC-8-300	28	19.7	19	7	2	28
De Havilland DHC-8-100	36	22.2	29	-	7	36
<b>Total Operating Aircraft</b>	<b>128<sup>(1)</sup></b>	<b>15.4</b>	<b>48</b>	<b>7</b>	<b>73</b>	<b>137</b>

(1) Refer to Section 10 - Economic Dependence for further discussion of the temporary reduction in the number of covered aircraft.



On May 11, 2010, Jazz expanded its charter fleet with the addition of a CRJ-200. The addition of the CRJ brings the number of aircraft to five for charter services.

All aircraft in Jazz's operating fleet as of June 30, 2010 are Covered Aircraft under the CPA, except for two Dash 8-100, two Dash 8-300, and one CRJ-200 aircraft allocated for charter purposes.

Air Canada's commitment to Jazz's minimum fleet of Covered Aircraft was reduced from 133 to 123 aircraft pursuant to the CPA Amending Agreement. The subleases for eight CRJ-200 and two CRJ-100 aircraft expired April 30, 2010 and these aircraft have been removed from the Jazz fleet. Following the return of these ten aircraft, the Jazz fleet will be temporarily reduced to 123 aircraft. As at June 30, 2010, four of these CRJ aircraft have been returned to the lessor, five continue to be prepared for return and one remains in the Jazz fleet pursuant to a new lease arrangement and is being used to operate charter flights.

## 15. CONTROLS AND PROCEDURES

---

### Disclosure controls and procedures and internal control over financial reporting

Jazz's disclosure controls and procedures have been designed to provide reasonable assurance that all relevant information is identified to the disclosure committee to ensure appropriate and timely decisions are made regarding public disclosure.

Internal control over financial reporting has been designed to provide reasonable assurance regarding the reliability of Jazz's financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

Jazz's 2009 MD&A dated February 9, 2010, contains a statement that the President and Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") have concluded that the Fund's disclosure controls and procedures, and internal control over financial reporting, are effective based upon an evaluation of these controls and procedures conducted at December 31, 2009.

Jazz filed certifications, signed by the CEO and CFO, with the Canadian Securities Administrators upon filing of Jazz's 2009 annual filings. In those filings, the CEO and CFO certified, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design and effectiveness of Jazz's disclosure controls and procedures and the design and effectiveness of internal control over financial reporting. The CEO and CFO also certified the appropriateness of the financial disclosures in Jazz's interim filings with the Canadian Securities Administrators. In those interim filings, the CEO and CFO also certified the design of Jazz's disclosure controls and procedures and the design of internal control over financial reporting.

Internal control over financial reporting has been designed, based on the framework established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), to provide reasonable assurance regarding the reliability of Jazz's financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

Because of inherent limitations, internal control over financial reporting and disclosure controls can provide only reasonable assurances and may not prevent or detect misstatements. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

There has been no change in Jazz's internal control over financial reporting during the second quarter of fiscal 2010 that has materially affected, or is reasonably likely to materially affect, Jazz's internal control over financial reporting.

The Audit, Finance and Risk Committee of the board of trustees of Jazz and the board of directors of Jazz GP reviewed this MD&A, and the unaudited interim consolidated financial statements of Jazz for June 30, 2010, and Jazz's board of trustees and Jazz GP's board of directors approved these documents prior to their release.



## 16. OUTLOOK

---

The discussion that follows represents forward-looking information. Refer to Caution regarding forward-looking information on page 1 of this MD&A.

Based on the 2009 and 2010 winter schedule and 2010 planning assumptions received from Air Canada and the initial planned flying for Thomas Cook, Jazz anticipates billing between 375,000 and 379,000 Block Hours for the year ending December 31, 2010.

## 17. RISK FACTORS

---

For a detailed description of the possible risk factors associated with Air Canada, Jazz, the industry, the structure of Jazz, current legal proceedings, and convertible debentures, refer to the Section entitled "Risk Factors" in the Jazz Air Income Fund, 2009 MD&A dated February 9, 2010 and Jazz's Annual Information Form dated March 30, 2010.

There have been no material changes to the risk factors disclosed in those documents, other than as described below.

### **Risks Relating to Jazz**

#### *Labour costs and labour relations*

On March 27, 2010 Jazz reached a three year agreement with its dispatcher employees represented by CALDA. On June 25, 2010, Jazz reached a six year agreement with its pilots represented by ALPA, which was ratified on July 9, 2010 by a union vote. On June 30, 2010, Jazz reached a six year agreement with its flight attendants represented by CFAU, which was ratified on July 16, 2010 by a union vote. The successful negotiation of these agreements has prevented the possibility of labour actions that could have disrupted Jazz's service in the event of a failure to settle the terms of these agreements.

#### *Leverage and restrictive covenants in current and future indebtedness*

The Credit Facilities matured on February 1, 2010 and all amounts owing thereunder were repaid and the related security was released. The risks previously identified as being associated with the Credit Facilities are therefore no longer applicable.

### **Risks Relating to Thomas Cook**

On April 2, 2010, Jazz signed a flight services agreement with Thomas Cook to operate no less than six Boeing 757-200 aircraft. The service will commence in November 2010, subject to Jazz obtaining the required regulatory approvals and the execution of definitive leasing and maintenance agreements with Thomas Cook Airlines Ltd. The agreement is expected to generate approximately \$100.0 million in additional annual revenue. There can be no assurance that the required regulatory approvals will be obtained or that the other conditions will be satisfied. Any failure to satisfy these conditions would result in a delay or inability of Jazz to commence service.

### **Risks Relating to Current Legal Proceedings**

In February 2006, Jazz commenced proceedings before the Ontario Superior Court of Justice against the Toronto Port Authority ("TPA"), Porter Airlines Inc. ("Porter") and other defendants (collectively with Porter, the "Porter Defendants") after Jazz became aware that it would be excluded from operating flights from Toronto City Centre (Island) Airport (the "TCCA"). On October 26, 2007, Porter counterclaimed against Jazz and Air Canada alleging various violations of competition law, including that Jazz and Air Canada's commercial relationship contravenes Canadian competition laws, and claiming \$850.0 million in damages. Concurrently with the Ontario Superior Court of Justice proceedings, Jazz commenced judicial review proceedings against the TPA before the Federal Court of Canada relating to Jazz's access to the TCCA. The Porter Defendants were granted intervener and party status in these proceedings. In January of 2008, Porter filed a defence and counterclaim against Jazz and Air Canada making allegations and seeking damages similar to those in the Ontario Superior Court counterclaim. On October 16, 2009, Jazz discontinued its action in the Ontario Superior Court against the Porter Defendants and the TPA. On the same date, the counterclaim filed by Porter in the Ontario Superior Court against Jazz and Air Canada was stayed pending the outcome of the proceeding in Federal Court. On March 29, 2010, Jazz discontinued its action in the Federal Court of Canada against the TPA, in which the Porter Defendants intervened and were made parties. On May 14, 2010 Porter discontinued its counterclaim



in the Federal Court. The counterclaim against Jazz and Air Canada brought by Porter in the Ontario Superior Court continues to be stayed. Jazz maintains that Porter's counterclaim is without merit. If Porter successfully re-activates its counterclaim, it will be vigorously contested by Jazz and Air Canada in court. If Jazz is not successful in defending the counterclaim, it could be subject to a material damages award.

## 18. GLOSSARY OF TERMS

---

**Available Seat Mile (ASMs)** - Available Seat Mile means a measure of passenger capacity calculated by multiplying the total number of seats available for passengers by the number of miles flown;

**Billable Block Hours** - Billable Block Hours mean actual Block Hours flown under the CPA plus Block Hours related to weather and air traffic control cancellations, and commercial cancellations and commercial ferry flights;

**Block Hours** - Block Hours mean the number of minutes elapsing from the time the chocks are removed from the wheels of an aircraft until the chocks are next again returned to the wheels of the aircraft, divided by 60;

**Controllable Costs** - Controllable Costs mean for any period, all costs and expenses incurred and paid by Jazz with respect to the Scheduled Flights and the Aircraft Services, as defined in the CPA, other than pass-through costs, but including any incentive compensation expense;

**Cost per Available Seat Mile (CASM)** - Cost per Available Seat Mile means the operating expense per Available Seat Mile;

**Covered Aircraft** - Covered Aircraft are Jazz's aircraft subject to the CPA;

**CPA** - CPA means the amended and restated capacity purchase agreement effective January 1, 2006, between Air Canada and the Partnership, as amended by the Rate Amending Agreement and the CPA Amending Agreement, and as may be further amended;

**CPA Amending Agreement** - CPA Amending Agreement means the agreement to amend the CPA between the Partnership and Air Canada dated September 22, 2009;

**CPA Asset** - CPA Asset means the intangible asset consisting of Jazz's rights under the CPA;

**Credit Facilities** - Credit Facilities mean the senior secured syndicated facilities in the aggregate amount of \$150 million established pursuant to a credit agreement dated February 2, 2006, between Jazz, as borrower, the financial institutions identified therein, as Lenders and Royal Bank of Canada, as administrative agent;

**FTE** - FTEs are full-time equivalents in respect of employee staffing levels;

**Fund** - Fund means Jazz Air Income Fund;

**IPO** - IPO means initial public offering;

**Jazz** - Jazz means Jazz Air Income Fund, Jazz Air Trust, and where the context requires, Jazz Air LP, together with its general partner, Jazz GP and their respective subsidiaries and predecessors;

**Jazz GP** - Jazz GP means Jazz Air Holding GP Inc., a corporation incorporated under the Canada Business Corporations Act on August 23, 2005, to act as the general partner of the Partnership;

**LARAH** - LARAH means Latin American Regional Aviation Holding Corp;

**Maintenance Capital Expenditures** - represent expenditures incurred to sustain operations or Jazz's productive capacity;

**Operating Aircraft** - Operating Aircraft means Covered Aircraft under the CPA plus charter aircraft less new aircraft deliveries which have not yet entered commercial service;

**Operating expenses** - Operating expenses means operating expenses before amortization of CPA Asset;

**Pluna** - Pluna means Pluna Líneas Aéreas Uruguayas S.A.;



**Rate Amending Agreement** - Rate Amending Agreement means the agreement to amend and re-set the rates between the Partnership and Air Canada dated July 28, 2009;

**Scheduled Flights** - Scheduled Flights mean the flights operated by the Covered Aircraft whose routes, schedules and fares are determined by Air Canada in accordance with the CPA;

**The Partnership** - The Partnership means Jazz Air LP;

**Thomas Cook** - Thomas Cook means Thomas Cook Canada Inc.;

**Trust** - Trust means Jazz Air Trust; and

**Units or Fund Units** - Units or Fund Units mean units of the Fund.