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**Jazz Air Income Fund**  
2009 Annual Report

Jazz is Canada's airline, operating more flights and flying to more Canadian destinations than any other. Under a long-term Capacity Purchase Agreement (CPA) with Air Canada, we act as a contract carrier operating flights on Air Canada's behalf to and from smaller communities, as well as on long haul, low demand routes across North America, and on high demand routes at larger centres during off-peak times.

Our agreement with Air Canada provides a stable and sustainable source of distributable cash for our Unitholders. Looking ahead, our focus is to build on this solid foundation by strengthening and expanding our relationship with Air Canada while growing our business in other areas that capitalize on the considerable experience and expertise of our people.

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# 2009 Highlights

## Solid Financial Results

### Jazz Air Income Fund

Years ended December 31,	2009	2008
(\$000's)		
Operating Revenue	1,473,900	1,636,289
Operating Income	88,774	106,171
Net Income (loss)	92,638	(9,410)*
Distributable Cash	139,266	144,684
Distributions Declared	102,787	123,552

\*includes a goodwill impairment loss of \$153,230



## Strong Performance

**Excellent safety record**

**Consistent monthly cash distributions**

**Experienced and dedicated employees**

**Industry-leading on-time performance**

**Industry-leading flight completion rate**

**Effective cost management**

**Strong presence across Canada**

**Multiple niche markets**

**Efficient Canadian built fleet**

**Strong demand for charter services**

# Jazz is Canada's largest regional carrier

**800+**  
daily flights

**86**  
destinations

**4,900**  
employees

**137**  
aircraft

**8,800,000**  
passengers

As Canada's largest regional carrier, we cover Canada and the United States like no other, operating more flights to more Canadian destinations than any other airline.

Our dedicated team of more than 4,900 people and our fleet of 137 modern aircraft serve more than 86 destinations with over 800 weekday departures.

# Industry Leading Performance

Despite the challenges faced by North American airlines during the year, Jazz posted operating and financial performance in 2009 that is among the best in our industry. With a renewed long-term core relationship with Air Canada, and improving industry fundamentals, we are now focusing our efforts on growth and diversifying our revenue base.

## **Strong Operating and Financial Performance**



*Joseph D. Randell,  
President and Chief Executive Officer,  
Jazz Air Income Fund*

As the country's largest regional airline, nobody covers Canada like Jazz. In 2009, we carried nearly 9 million passengers to over 80 destinations across North America. Once again, our 4,900 experienced and dedicated employees worked diligently to ensure that our more than 800 daily departures were completed safely and on-time, providing our customers with a pleasant travel experience.

Despite reduced demand in the North American airline industry, the commitment of our people, our solid management practices, our successful focus on cost control, and our uncompromising attention to safety and operational excellence generated solid financial and operating performance in 2009. Results that were among the best in the North American airline industry.

Controllable on-time performance was 86%, and our controllable flight completion was an impressive 99.2%. Our excellent customer service contributed to Jazz achieving 84% of the maximum available performance incentive payments from Air Canada under our Capacity Purchase Agreement (CPA) in the amount of \$19 million, well-above the \$15.7 million received in 2008, and the best operational performance since our initial public offering in early 2006. We also made significant strides in cost control by leveraging the investments made over the past years in technology and automation to strengthen our business operations.



### **Renewing our Relationship with Air Canada**

Our long-term relationship with Air Canada, as defined in our Capacity Purchase Agreement, is the core of our business and provides a very stable foundation on which to build going forward. As Canada's largest regional airline, we play a unique and integral role in Air Canada's network strategy, essentially acting as a contract carrier serving markets that do not have sufficient passenger traffic to support Air Canada's larger aircraft, while at the same time offering greater flight frequency and customer convenience in high-density markets with our smaller aircraft and lower costs. Our point-to-point service on lower density routes also provides additional convenience as customers can enjoy non-stop service while by-passing busy hub airports.

For our Unitholders, Jazz is protected from the cost volatility that has impacted so many of our competitors in these uncertain times, including such major items as fuel and airport fees. These costs are passed directly through to Air Canada and fully recovered by Jazz. The agreement also provides guarantees on the use of virtually all of our aircraft. In short, the CPA protects our cash flows, provides stability for our cash distributions, and gives us a solid foundation on which to grow and diversify.

While Jazz achieved outstanding performance in 2009, the North American airline industry remained challenging during the year. Over-capacity concerns were very real, demand remained soft, and the cost of operating an airline escalated.

As a result of these challenges, during the second quarter of 2009, Air Canada requested assistance from all its major stakeholders to help address its financial challenges. As a good partner, and one that values the business of our most important customer, we explored several options with Air Canada to chart a course of action that we believe will deliver the most value to Jazz stakeholders.

At Jazz, we want a healthy Air Canada, as well as a relationship that provides a strong foundation from which to grow. We also believe that being part of the solution for Air Canada is the best course of action, bringing to our partner the strengths of our lower costs, basic economics, expertise, culture, healthy employee relations, and the size and scope of our presence.

Following long and often difficult discussions, we were pleased to have negotiated an industry-leading agreement that is both meaningful for our employees and stakeholders, and strengthens our relationship with an important customer. Effective August 1, 2009, we amended the CPA as follows:

- The five-year contract extension to 2020 is industry-leading and allows us to focus on our stability and growth.
- The confirmed target of 375,000 annual block hours provides predictability in our revenues and costs without the need for a substantial disruption to our workforce and our finances.
- The reduction in the mark-up which Jazz charges to Air Canada to 12.50% on the first 375,000 annual block hours and 5% on any additional block hours, helps Air Canada be more competitive within the North American market and encourages them to use more of our services.

The amended CPA also defines how Jazz will renew its airline fleet going forward. Commencing in May 2011, on a one-per-month basis, Jazz will begin replacing CRJ100/200 regional jets with larger, more modern, cost-effective and environmentally-friendly turboprop aircraft. These new airplanes will improve our service and reduce controllable operating costs through improved fuel economics and lower maintenance expenditures.

We believe Jazz has achieved the best situation possible

During the year we negotiated a new, industry-leading agreement with Air Canada that strengthened our relationship and benefitted our employees and stakeholders.



during these uncertain economic times as well as the risks revolving around Air Canada, and that these changes in the CPA will help deliver enhanced value over the long-term.

Although Air Canada has been successful in addressing its immediate concerns, the situation in the global airline industry remains very fragile. As a result, we continue to work on contingency planning and proactively charting our course for the future. The amendments to the CPA support these endeavours by providing relative stability, predictability and time.

With the reduction in block hours and mark-up resulting from the amendments to the CPA, we took the prudent step of reducing our cash distributions to Unitholders in August 2009 to an annual rate of \$0.60 per Unit. While we regret having to take this step, we are confident this new level is sustainable and will be funded through our operating cash flow.

### **Key Achievements**

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An important milestone achieved in 2009 was the successful closing of a 9.5% convertible debenture offering in November. Despite the volatility in the North American capital markets, the offering was very well-received and, including the ex-

ercise of the over-allotment option, gross total aggregate proceeds were over \$86 million. The funds greatly enhanced our balance sheet and liquidity position. Net proceeds from the offering will be used for working capital requirements and for general purposes of the Fund. This may include, among other uses, funding deposit amounts in respect of our re-fleeting program, repaying outstanding indebtedness, and funding possible future acquisitions.

We were very pleased during 2009 to have ratified our labour agreements with Jazz Maintenance and Engineering, and Customer Service and Aircraft Services divisions. Negotiations with the remaining groups of crew schedulers, flight attendants, pilots and dispatchers continue, and we remain optimistic new collective agreements will be reached. Our goal is to achieve mutually beneficial contracts that will allow Jazz to grow and diversify.

We were also delighted to appoint Colin Copp as Chief Administrative Officer and Jolene Mahody as Chief Operating Officer. Colin and Jolene have extensive experience in our business and have already rejuvenated their divisions with a view to delivering greater efficiency, transparency and better productivity. Importantly, these appointments resulted in a reduction in Jazz's executive committee and an improved and more cost-effective overhead structure.



With a renewed and stable core business and improving airline industry fundamentals, our focus has returned to strategies aimed at growing and diversifying our revenue base.

Safety remains our top priority at Jazz, and during 2009 we implemented a number of new and updated programs and initiatives to improve effectiveness and efficiency with the goal of remaining among the safest airlines in the world. For example, during the year we implemented a new method to analyze and categorize identified issues, helping to identify trends and to prevent future repetitive occurrences and allowing us to be more proactive in terms of eliminating similar problems.

### **A Focus on Growth and Diversification**

With the stability in our core business provided by the amended CPA with Air Canada, and a gradually improving outlook for the North American airline industry, our attention has returned to our stated strategies aimed at growing and diversifying our revenue base.

First, we will continue to work with Air Canada to increase their utilization of Jazz services and network capabilities under our CPA. We have proven that Jazz can operate profitably under the terms of the amended CPA, and we will continue to look for ways to expand our business and maintain our strong track record of achieving performance incentives.

Second, growing our charter program, which operates outside of the CPA, remains a priority as our smaller aircraft provide a compelling value proposition for individuals and organizations seeking the convenience of airline charters. During 2009 this area remained strong and experienced moderate growth as we generated increased usage from a number of sectors, including hunting and fishing lodges in British Columbia. As we enter the new year, we are also seeing renewed interest from the oil and gas sector in western Canada. The renewal of our fleet with the addition of larger turboprops will also help to expand our charter business.

Third, we will continue to leverage the expertise and innovation of our people. At Jazz, we possess a highly skilled workforce trained in the operation of one of the world's largest fleets of regional aircraft. The regional airline market has remained relatively strong during the slow economic times of the last two years, and there is a solid opportunity to capitalize on the capacity and skills of our technical operations team. As an example, in 2009 we worked closely with a regional airline in South America to successfully enhance their fuel efficiency and operational performance.

Finally, we are always looking for new strategic partners to expand our services and operations. New capacity purchase agreements or extended charter agreements with





other airlines, both inside and outside of North America, provide an opportunity for growth and revenue diversification. In addition, the opportunity exists to provide various consulting and operating services to other airline operators to build our revenues over the long term.

Many of these growth strategies are aimed at diversifying our revenue sources for the benefit of our Unitholders. Since entering the public capital markets the majority of our business has been derived from our CPA with Air Canada. While we will continue to build on this core business, we are working to diversify our revenue base including expanding our charter business, strategic relationships with other airlines, and leveraging the skills and expertise of our people. We will also continue to examine the opportunity to grow through acquisition, potentially capitalizing on the current consolidation trend that is occurring in the global regional airline business. We are very excited about our future, and believe the revenue diversification will enhance the sustainability of our cash flows and add significant value to Jazz and our Unitholders.

Looking ahead, we are also preparing to restructure from an income trust to a corporation. This conversion is being driven by taxation of income trusts mandated by the Canadian federal government beginning in 2011. The Board of

Trustees is working diligently on a conversion proposal that is in the best interests of Jazz and Unitholders, and we will keep you apprised of our progress through the new year.

In closing, we are very proud of the successes achieved in 2009, and I would like to thank all of our employees for their dedication and hard work. While the regional airline industry faced serious challenges over the last year, our people rose to the occasion and delivered record performance. We look forward to another year of strong results in 2010, and in the years ahead.

A handwritten signature in black ink, reading "Joseph D. Randell". The signature is written in a cursive, flowing style.

Joseph D. Randell  
*President and Chief Executive Officer*

# Well Positioned to Deliver Sustainable Growth

With industry-leading performance in 2009, a renewed and strengthened relationship with Air Canada, and an improving long-term outlook for the global airline industry, we are confident Jazz is well positioned to deliver stable growth in the years ahead.

Despite the significant challenges faced by the global airline industry in 2009, Jazz delivered operating and financial performance that was among the best in its business. By focusing on cost control, operating efficiency, and an uncompromising attention to customer service and safety, our people once again made Jazz the choice for travelers seeking the convenience and value of one of the world's leading regional airlines.

A key accomplishment in 2009 was the redefining of our relationship with Air Canada. We commend both our management team and Air Canada for achieving a new agreement that helps our key customer remain competitive while providing Jazz with a solid foundation from which to grow and diversify.

Looking ahead, we are confident Jazz is well positioned to capitalize on the improving fundamentals in the global airline business. We will continue to work with Air Canada to increase their utilization of our services and capabilities. Our expanding fleet of charter aircraft remains a source of revenue growth, and we will continue to build this aspect of our business. Our solid performance in 2009 highlights the skill and experience of our people, and we will leverage this expertise to enhance our market presence. With a strengthened balance sheet resulting from the successful financing completed in 2009, we will look for additional ways to grow and diversify our revenue base.

During 2010 the Board of Trustees will also determine



*Richard H. McCoy  
Chairman,  
Jazz Air Income Fund*

the most appropriate path to convert from an income trust structure to a corporation, and we are confident we will propose a solution that best meets the needs of Jazz and its Unitholders.

In closing, on behalf of the Board I would like to thank everyone at Jazz for their diligence and dedication during a most challenging year. I also extend my thanks to the talented and experienced members of the Board for their support.

A handwritten signature in black ink that reads "R.H. McCoy".

Richard H. McCoy  
*Chairman*

# MD&A

## Management's Discussion and Analysis

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The following management's discussion and analysis of financial condition and results of operations ("MD&A") of Jazz Air Income Fund ("the Fund") is prepared as at February 9, 2010 and should be read in conjunction with the accompanying audited consolidated financial statements of the Fund and the notes therein for the year ended December 31, 2009. The audited consolidated financial statements of the Fund are prepared in accordance with generally accepted accounting principles ("GAAP") in Canada.

The Fund is entirely dependent upon the operations and financial condition of Jazz Air LP (the "Partnership"). The earnings and cash flows of the Fund are affected by certain risks. For a description of those risks, please refer to Section 17 – Risk Factors.

As a result of the different ownership percentages of the Partnership held indirectly by the Fund throughout the periods presented, which have resulted in different bases of accounting (from equity to consolidation), figures presented for the Fund for periods prior to 2008 are not comparative. The Fund's operating income, net earnings, and earnings per unit have been adjusted to remove the effect of certain consolidation amounts (i.e. by adding back amortization

of Capacity Purchase Agreement ("CPA") asset, goodwill impairment loss, and future income taxes), in order to present results which are comparable to those previously reported by the Partnership.

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 February 9, 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

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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. 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 and Jazz GP) 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 and strategy. Jazz and Air Canada are parties to the Capacity Purchase Agreement ("CPA"), pursuant to which Air Canada currently purchases substantially all of Jazz's fleet capacity based on 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 775 departures per weekday to 56 destinations in Canada, and 26 destinations in the United States, with Covered Aircraft of 130 as of December 31, 2009. 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 at set rates which are based on a variety of different metrics that are substantially independent of Passenger Load Factor. 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 on the schedule specified by Air Canada.

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 for successfully achieving certain performance levels on a quarterly basis 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 by Air Canada under the CPA for the three year period ending December 31, 2011. The new rates are retroactive to January 1, 2009 (refer to Section 10 – Economic Dependence for further discussion of 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 formally reflect certain amendments to the CPA (refer to Section 10 – Economic Dependence).

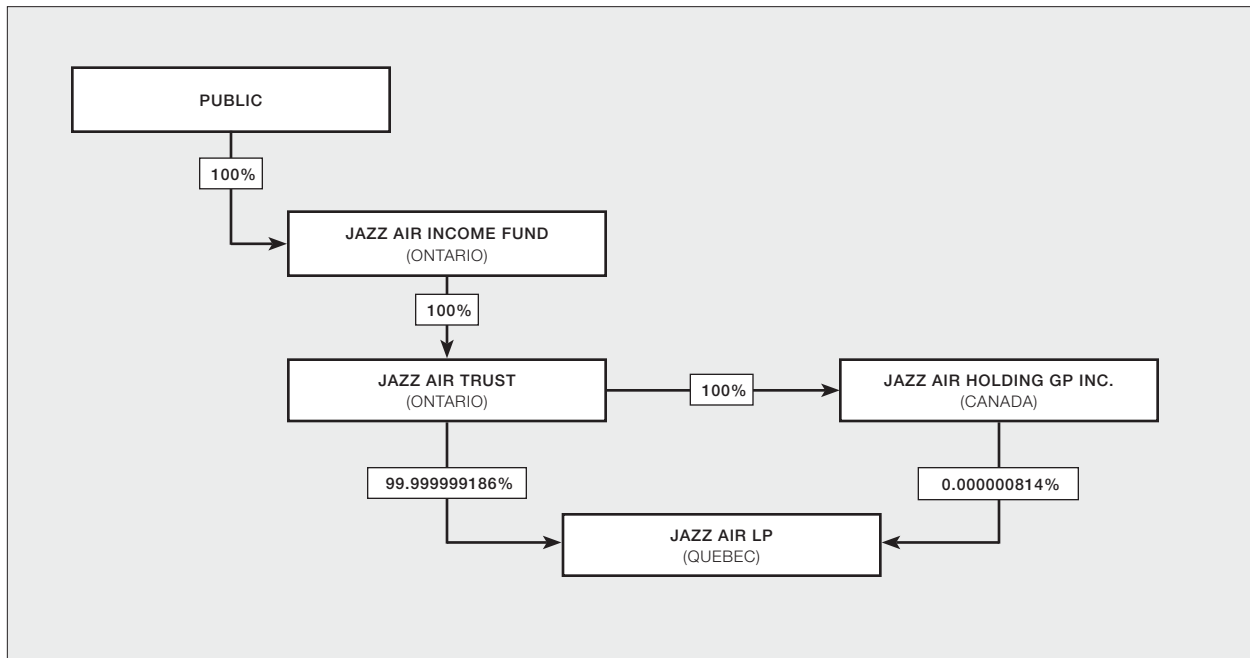
Jazz is directly affected by the financial and operational strength of Air Canada, its competitive position, and its ability to maintain sufficient liquidity. For further discussion, please see Section 17 – Risk Factors.

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 for further discussion of the CPA).

Most of Jazz's employees are unionized and its collective bargaining agreements all expired at the end of June 2009. Jazz has pursued negotiations with each union. On August 30, 2009, Jazz reached a tentative three year agreement with its maintenance and engineering employees who are represented by the Canadian Auto Workers ("CAW"). That tentative agreement was subsequently ratified on September 12, 2009, by a union vote. On December 3, 2009, Jazz reached a tentative three year agreement with its Customer Services and Aircraft Services divisions, also represented by the CAW. That tentative agreement was subsequently ratified on December 16, 2009 by a union vote. Jazz is currently in negotiations with all other unionized groups of employees.

## Organizational structure

The following chart illustrates, on a simplified basis, the structure of Jazz (including the jurisdictions of establishment and incorporation of the various entities) and the indirect investment by Jazz in the Partnership as at December 31, 2009.



## 2. HIGHLIGHTS

### Fourth quarter 2009 vs fourth quarter 2008 highlights

- Achieved 89% of the incentives available under the CPA.
- First full quarter of operating results reflecting the amended CPA with Air Canada and reflecting the beginning of a temporary fleet reduction plan, reducing the number of covered aircraft from 133 to 123 aircraft. Beginning May 2011, Jazz will increase the covered fleet up to 125 coincidental with a new turboprop fleet renewal strategy contemplated in the amended CPA with Air Canada.
- Distributable cash of \$26.7 million for the three months ended December 31, 2009, compared to \$37.4 million, down 28.5% or \$10.7 million, primarily as a result of the controllable markup reduction and fleet reduction.
- Billable Block Hours down 6.6% and operating income, before amortization of CPA Asset, down 36.3% or \$14.4 million for the three months ended December 31, 2009, primarily as a result of both the controllable markup reduction and fleet reduction.
- EBITDA of \$33.3 million for the three months ended December 31, 2009, down \$14.3 million or 30.1% as a result of both the controllable markup and fleet reduction.
- Successful completion of public offering of convertible unsecured subordinated debentures, which raised aggregate net proceeds of \$82.3 million to be used for working capital purposes.

**Key Financial Information**

	Three months ended December 31,		Year ended December 31,		
	2009	2008	2009	2008	2007 <sup>(1)</sup>
(expressed in thousands of Canadian dollars, except per unit amounts)	\$	\$	\$	\$	\$
Revenue	351,238	392,684	1,473,900	1,636,289	1,495,389
Operating income	17,258	29,202	88,774	106,171	153,159
Net income (loss)	20,816	(86,493)	92,638	(9,410)	150,654
Total assets	1,266,471	1,233,147	1,266,471	1,233,147	518,502
Total long-term liabilities	159,270	214,939	159,270	214,939	191,382
EBITDA <sup>(2)</sup>	33,261	47,604	159,086	178,680	177,466
Distributions declared	18,429	30,888	102,787	123,552	123,552
Distributable cash <sup>(2)</sup>	26,743	37,418	139,266	144,684	151,282
Standardized distributable cash <sup>(2)</sup>	9,063	27,412	118,608	134,609	120,104
Cash provided by operating activities	12,910	32,637	130,089	155,088	143,767
Per Unit <sup>(3)</sup>					
Operating income	0.14	0.24	0.73	0.87	1.25
Net income (loss)	0.17	(0.71)	0.76	(0.08)	1.23
Distributions declared	0.15	0.25	0.84	1.01	1.01
Distributable cash	0.22	0.31	1.14	1.19	1.23
Standardized distributable cash	0.07	0.22	0.97	1.10	0.98

(1) 2007 results for comparative purposes are those of the Partnership.

(2) These are non-GAAP measures. Refer to Section 6 – Performance Indicators.

(3) Calculated on a basic weighted average number of units for Jazz.

**Key statistical information**

Statistical information for the three months and year ended December 31, 2009 is as follows:

	Three months ended December 31,			Year ended December 31,		
	2009	2008	Variance %	2009	2008	Variance %
Departures	65,430	67,552	(3.1)	274,667	286,820	(4.2)
Block Hours	89,529	95,130	(5.9)	377,985	401,041	(5.7)
Billable Block Hours	91,783	98,232	(6.6)	386,220	410,764	(6.0)
Passengers	2,079,441	2,244,562	(7.4)	8,755,193	9,718,207	(9.9)
Revenue Passenger Miles (RPMs) (000's)	850,075	937,993	(9.4)	3,658,347	4,104,053	(10.9)
Available Seat Miles (ASMs) (000's)	1,265,084	1,319,052	(4.1)	5,392,284	5,657,022	(4.7)
Passenger Load Factor (%)	67.2	71.1	(5.5)	67.8	72.5	(6.5)
Operating Expenses (\$000's)	325,932	352,957	(7.7)	1,345,503	1,488,018	(9.6)
Cost per Available Seat Mile (CASM) (¢)	25.76	26.76	(3.7)	24.95	26.30	(5.1)
CASM Excluding Aircraft Fuel (¢)	20.65	19.98	3.4	20.21	18.70	8.1
Controllable CASM (¢)	16.01	15.40	4.0	15.90	14.49	9.7
Number of Operating Aircraft (end of period) <sup>(1)</sup>	134	137	(2.2)	134	137	(2.2)
Full-Time Equivalents (FTEs) (end of period)	4,508	4,388	2.7	4,508	4,388	2.7

(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 consolidated financial statements for the year ended December 31, 2009.

(expressed in thousands of Canadian dollars, except per unit amounts)	Three months ended December 31,			Year ended December 31,		
	2009 \$	2008 \$	Variance %	2009 \$	2008 \$	Variance %
Operating revenue	351,238	392,684	(10.6)	1,473,900	1,636,289	(9.9)
Operating expenses	325,932	352,957	(7.7)	1,345,503	1,488,018	(9.6)
Operating income						
before amortization of CPA Asset <sup>(1)</sup>	25,306	39,727	(36.3)	128,397	148,271	(13.4)
Amortization of CPA Asset <sup>(1)</sup>	8,048	10,525	(23.5)	39,623	42,100	(5.9)
Operating income	17,258	29,202	(40.9)	88,774	106,171	(16.4)
Non-operating expenses	(2,111)	(158,017) <sup>(2)</sup>	(98.7)	(6,403)	(166,565) <sup>(2)</sup>	(96.2)
Income (loss) before future income taxes	15,147	(128,815)	111.8	82,371	(60,394)	236.4
Recovery of future income taxes <sup>(3)</sup>	5,669	42,322	(86.6)	10,267	50,984	(79.9)
Net income (loss) for the period	20,816	(86,493)	124.1	92,638	(9,410)	1,084.5
Adjusted net income <sup>(4)</sup>	23,195	34,940	(33.6)	121,994	134,936	(9.6)
Adjusted net income <sup>(4)</sup> per unit	0.19	0.29	(34.5)	1.00	1.11	(9.9)

(1) The CPA Asset was recorded at fair value as a result of Jazz's step purchase of the Partnership during 2007. 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) Includes a goodwill impairment loss of \$153.2 million.

(3) 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.)

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

### 4. FOURTH QUARTER ANALYSIS

The following discussion compares the results of operations of Jazz for the three months ended December 31, 2009 to the three months ended December 31, 2008.

#### Operating Revenue

Operating revenue decreased from \$392.7 million to \$351.2 million in the fourth quarter of 2009, representing a decrease of 10.6%. This decrease in revenue was primarily attributable to a \$26.4 million, or a 17.6%, decrease in pass-through costs under the CPA, reduced Billable Block Hours of 6.6%, a 3.1% 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 further discussion); offset by rate increases made pursuant to the CPA.

Performance incentives payable by Air Canada to Jazz under the CPA amounted to \$4.6 million or 2.1% of Jazz's Scheduled Flights Revenue. For the same period in 2008, performance incentives under the CPA amounted to \$3.6 million or 1.5% of Jazz's Scheduled Flights Revenue.

Other revenue earned from charter flights and other sources, such as groundhandling, decreased from \$3.7 million to \$2.2 million.

#### Operating Expenses

Operating expenses decreased from \$353.0 million to \$325.9 million, a decrease of \$27.1 million or 7.7%.

- Salaries, wages and benefits increased by \$0.7 million due to increased FTE's in operational areas and wage and scale increases under collective agreements; offset by a reduction in pension expense arising as a result of a revised actuarial valuation.
- Aircraft fuel costs decreased by \$24.7 million due to a decrease of \$20.8 million in the cost of fuel, and a \$3.9 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 changes in accounting estimates for aircraft and certain flight equipment, and other assets reaching full amortization at the end of 2008.

- Aircraft maintenance expense increased by \$7.8 million as a result of increased rates under new maintenance contracts of \$9.8 million, and other maintenance costs of \$2.7 million; offset by the effect of the decrease in the US dollar exchange rate on certain material purchases of \$4.7 million.
- Airport and navigational fees decreased by \$1.9 million due to a decrease in airport fees of \$1.4 million and a decrease in navigational fees of \$0.5 million arising as a result of changes in aircraft deployment and a decrease in departures of 3.1%; offset by a general rate increase.
- Aircraft rent decreased by \$4.7 million primarily arising as a result of a lower US dollar exchange rate.
- Terminal handling costs decreased by \$4.5 million due to a reduction in the number of departures, changes in aircraft deployment which resulted in rate decreases, and a decrease in de-icing costs.
- Other expenses increased by \$0.1 million due to an increase in general overhead expenses.

### Non-Operating Expenses

Non-operating expenses amounted to \$2.1 million, a decrease of \$155.9 million. The change was mainly attributable to a reduction in foreign exchange loss arising as a result of the change in value of the Canadian dollar relative to the US dollar, a gain on the disposal of property and equipment and in 2008 a goodwill impairment loss of \$153.2 million; offset by increased net interest expense.

Jazz's costs fall into two principal categories: (i) pass-through costs specified in the CPA, 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.

The following table presents Jazz's operating costs in a format that is consistent with the definition of pass-through and Controllable Costs as defined in the CPA:

	Three months ended December 31, 2009 \$	Three months ended December 31, 2008 \$	Change \$	Change %
<b>(expressed in thousands of Canadian dollars)</b>				
<b>Pass-through cost items</b>				
Fuel	64,686	88,966	(24,280)	(27.3)
Navigational fees	17,764	18,223	(459)	(2.5)
Airport user fees	28,282	29,494	(1,212)	(4.1)
De-icing	6,461	7,672	(1,211)	(15.8)
Terminal handling services	2,771	2,733	38	1.4
Aircraft rent <sup>(1)</sup>	1,377	–	1,377	100.0
Other	2,111	2,776	(665)	(24.0)
<b>Total pass-through costs</b>	<b>123,452</b>	<b>149,864</b>	<b>(26,412)</b>	<b>(17.6)</b>
<b>Controllable Cost items</b>				
Salaries, wages and benefits	83,910	83,212	698	0.8
Aircraft maintenance, materials and supplies	38,279	30,474	7,805	25.6
Aircraft rent <sup>(1)</sup>	30,415	36,456	(6,041)	(16.6)
Terminal handling services	16,961	20,271	(3,310)	(16.3)
Depreciation and amortization of property and equipment and other	7,955	7,877	78	1.0
Other	24,960	24,803	157	0.6
<b>Total Controllable Costs <sup>(2)</sup></b>	<b>202,480</b>	<b>203,093</b>	<b>(613)</b>	<b>(0.3)</b>
<b>Total Operating Costs</b>	<b>325,932</b>	<b>352,957</b>	<b>(27,025)</b>	<b>(7.7)</b>

(1) Pursuant to the terms of the CPA Amending Agreement, Air Canada and Jazz agreed, effective as of August 1, 2009, to treat the rent charged to Jazz for five of the CRJ100 aircraft as a pass-through cost (refer to Section 10 – Economic Dependence).

(2) Included costs relating to operations that were not covered under the CPA, such as charter costs.



## Operating margin performance

(expressed in thousands of Canadian dollars)	Three months ended December 31 2009				Three months ended December 31 2008			
	Revenue \$	Expenses \$	Operating Margin \$	Operating Margin %	Revenue \$	Expenses \$	Operating Margin \$	Operating Margin %
CPA	220,922	201,042	19,880	9.0	235,450	200,350	35,100	14.9
Pass-throughs	123,452	123,452	–	–	149,864	149,864	–	–
Incentives	4,628	–	4,628	100.0	3,621	–	3,621	100.0
Other	2,236	1,438	798	35.7	3,749	2,743	1,006	26.8
	<b>351,238</b>	<b>325,932</b>	<b>25,306</b>	<b>7.2</b>	<b>392,684</b>	<b>352,957</b>	<b>39,727</b>	<b>10.1</b>

The Controllable Adjusted Actual Margin for the fourth quarter of 2009 was 9.0%, which is less than the target margin established under the CPA of 11.11% (refer to Section 10 – Economic Dependence) by 211 basis points, or approximately \$4.7 million. In a quarter with less than the average Block Hour activity margins will be compressed. In the fourth quarter, this margin compression represented \$0.9 million of the shortfall from target level. The balance is primarily attributable to incentive compensation expense which is excluded from the CPA revenue rate development. In the fourth quarter of 2008, Controllable Adjusted Actual Margin was 14.91%, which was 82 basis points or approximately \$1.9 million greater than the target margin of 14.09%. Prior period rates provided sufficient margin to cover incentive compensation expense.

CPA revenue for the fourth quarter of 2009 decreased by 6.2% or \$14.5 million as a result of: a decrease in the mark-up from 16.40% to 12.50%, a lower US dollar exchange rate, a reduction

in the number of Billable Block Hours, and a change in the mark-up effective August 1, 2009 from 16.72% to 12.50% (refer to Section 10 – Economic Dependence); offset by an increase in the rates payable under the CPA.

CPA Controllable Costs increased by 0.3% or \$0.7 million primarily as a result of: increases in salaries, wages and benefits and aircraft maintenance, materials and supplies (refer to previous discussion on quarter-over-quarter changes in operating expenses).

Jazz earned 89% of the incentives available under the CPA, or \$4.6 million, as compared to last year's incentives of 65% or \$3.6 million. Incentives earned in the fourth quarter of 2009 were higher as a result of improvements in on-time performance and flight completion.

The margin on other revenue was earned from charter flights and other sources, such as ground handling services.

## 5. YEAR-TO-DATE ANALYSIS

The following discussion compares the results of operations of Jazz for the year ended December 31, 2009 to December 31, 2008.

### Operating Revenue

Operating revenue decreased from \$1,636.3 million to \$1,473.9 million, representing a decrease of 9.9%. This decrease in revenue was primarily attributable to a \$180.2 million, or a 27.0%, decrease in pass-through costs under the CPA, reduced Billable Block Hours of 6.0%, a 4.2% reduction in departures 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 further discussion); offset by a higher US dollar exchange rate and rate increases made pursuant to the CPA.

Performance incentives payable by Air Canada to Jazz under the CPA amounted to \$19.0 million or 2.0% of Jazz's Scheduled Flights Revenue. For the same period in 2008, performance incentives under the CPA amounted to \$15.7 million or 1.7% of Jazz's Scheduled Flights Revenue.

Other revenue earned from charter flights and other sources, such as groundhandling, decreased from \$13.4 million to \$10.3 million.

### Operating Expenses

Operating expenses decreased from \$1,488.0 million to \$1,345.5 million, a decrease of \$142.5 million or 9.6%.

- Salaries, wages and benefits decreased by \$0.7 million due to an overall lower average number of FTEs and a reduction in pension expense arising as a result of a revised actuarial valuation; offset by wage and scale increases under collective agreements, and increased incentive compensation expense.
- Aircraft fuel costs decreased by \$174.4 million due to a decrease of \$152.3 million in the cost of fuel, and a \$22.1 million decrease in fuel usage due to a reduction in the number of Block Hours.
- Depreciation and amortization expense increased by \$0.3 million due to increased capital expenditures on aircraft rotatable parts and other equipment; offset by changes in accounting estimates implemented during the second quarter of 2008 for aircraft and certain flight equipment, and other assets reaching full amortization at the end of 2008.
- Aircraft maintenance expense increased by \$34.1 million as a result of: the effect of the increase in the US dollar exchange rate on certain material purchases of \$4.4 million, increased rates under new maintenance contracts of \$26.2 million, and other maintenance costs of \$7.5 million; offset by a decrease in heavy maintenance outsourcing of \$4.0 million.

- Airport and navigational fees decreased by \$7.4 million due to a decrease in airport fees of \$5.3 million and a decrease in navigational fees of \$2.1 million arising as a result of changes in aircraft deployment, and a decrease in departures of 4.2%; offset by a general rate increase.
- Aircraft rent increased by \$7.9 million primarily arising as a result of higher US dollar exchange rates.
- Terminal handling costs decreased by \$5.4 million due to a decrease in de-icing costs, a reduction in the number of departures and changes in aircraft deployment which resulted in rate increases.
- Other expenses increased by \$3.0 million due to an increase in general overhead expenses which included professional fees associated with contingency planning and the CPA Amending Agreement.

### Non-Operating Expenses

Non-operating expenses amounted to \$6.4 million, a decrease of \$160.2 million. The change was mainly attributable to a gain on the disposal of property and equipment, a lower foreign exchange loss arising as a result of the change in value of the Canadian dollar relative to the US dollar and in 2008, a goodwill impairment loss of \$153.2 million; offset by increased net interest expense.

Jazz's costs fall into two principal categories: (i) pass-through costs specified in the CPA, 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 rent on certain aircraft, 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.

The following table presents Jazz's operating costs in a format consistent with the definition of pass-through and Controllable Costs as defined in the CPA:

	Year ended December 31, 2009 \$	Year ended December 31, 2008 \$	Change \$	Change %
<b>(expressed in thousands of Canadian dollars)</b>				
<b>Pass-through cost items</b>				
Fuel	255,011	427,743	(172,732)	(40.4)
Navigational fees	74,168	76,254	(2,086)	(2.7)
Airport user fees	117,684	122,712	(5,028)	(4.1)
De-icing	19,628	21,704	(2,076)	(9.6)
Terminal handling services	11,556	10,472	1,084	10.4
Aircraft rent <sup>(1)</sup>	2,314	–	2,314	100.0
Other	8,013	9,672	(1,659)	(17.2)
<b>Total pass-through costs</b>	<b>488,374</b>	<b>668,557</b>	<b>(180,183)</b>	<b>(27.0)</b>
<b>Controllable Cost items</b>				
Salaries, wages and benefits	344,505	345,210	(705)	(0.2)
Aircraft maintenance, materials and supplies	163,677	129,533	34,144	26.4
Aircraft rent <sup>(1)</sup>	133,366	127,758	5,608	4.4
Terminal handling services	70,800	75,169	(4,369)	(5.8)
Depreciation and amortization of property and equipment and other	30,689	30,409	280	0.9
Other	114,092	111,382	2,710	2.4
<b>Total Controllable Costs <sup>(2)</sup></b>	<b>857,129</b>	<b>819,461</b>	<b>37,668</b>	<b>4.6</b>
<b>Total Operating Costs</b>	<b>1,345,503</b>	<b>1,488,018</b>	<b>(142,515)</b>	<b>(9.6)</b>

(1) Pursuant to the terms of the CPA Amending Agreement, Air Canada and Jazz agreed, effective as of August 1, 2009, to treat the rent charged to Jazz for five of the CRJ100 aircraft as a pass-through cost (refer to Section 10 – Economic Dependence).

(2) Included costs relating to operations that were not covered under the CPA, such as charter costs.

**Operating margin performance – 2009 versus 2008**

(expressed in thousands of Canadian dollars)	Year ended December 31 2009				Year ended December 31 2008			
	Revenue \$	Expenses \$	Operating Margin \$	Operating Margin %	Revenue \$	Expenses \$	Operating Margin \$	Operating Margin %
CPA	956,240	849,065	107,175	11.2	938,643	809,193	129,450	13.8
Pass-throughs	488,374	488,374	–	–	668,557	668,557	–	–
Incentives	19,008	–	19,008	100.0	15,650	–	15,650	100.0
Other	10,278	8,064	2,214	21.5	13,439	10,268	3,171	23.6
	<b>1,473,900</b>	<b>1,345,503</b>	<b>128,397</b>	<b>8.7</b>	<b>1,636,289</b>	<b>1,488,018</b>	<b>148,271</b>	<b>9.1</b>

The Controllable Adjusted Actual Margin for the year ended 2009 was 11.21%, which is less than the weighted average target margin established under the CPA of 13.05% (refer to Section 10 – Economic Dependence) by 184 basis points, or approximately \$17.6 million. The shortfall was primarily attributable to incentive compensation expense which is excluded from the CPA revenue rate. For the year ended 2008, Controllable Adjusted Actual Margin was 13.79%, which was 30 basis points or approximately \$2.8 million less than the target margin of 14.09%. Prior period rates provided sufficient margin to cover incentive compensation expense.

CPA revenue increased by 1.9%, or \$17.6 million as a result of: an increase in the mark-up from 16.40% to 16.72% from January 1 to July 31, 2009 (resulting from Jazz's out-performance of the controllable target margin from 2006 to 2008), an increase in the

rates payable under the CPA, and a higher US dollar exchange rate; offset by a reduction in the number of Billable Block Hours and a change in the mark-up effective August 1, 2009 from 16.72% to 12.50% (refer to Section 10 – Economic Dependence).

CPA Controllable Costs increased by 4.9% or \$39.9 million primarily as a result of: increases in aircraft rent and aircraft maintenance, materials and supplies (refer to previous discussion on quarter-over-quarter changes in operating expenses).

Jazz earned 84% of the incentives available under the CPA, or \$19.0 million, as compared to last year's incentives of 71% or \$15.7 million. Incentives earned in 2009 were higher as a result of the increase in CPA controllable revenue and improvements in on-time performance and customer check-in satisfaction.

The margin on other revenue was earned from charter flights and other sources, such as ground handling services.

**6. PERFORMANCE INDICATORS**

Jazz uses certain non-GAAP financial measures, described below, to evaluate operating performance, to measure compliance with debt covenants 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). 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 \$102.8 million, respectively, for the three months and year ended December 31, 2009 (\$30.9 million and \$123.6 million for the three months and year ended December 31, 2008). 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, on the basis of performance and taking into account future cash requirements.

On July 28, 2009, the Trustees adjusted cash distributions in light of the amendments to the CPA 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:

	Three months ended December 31,		Year ended December 31,	
	2009	2008	2009	2008
(expressed in thousands of Canadian dollars)	\$	\$	\$	\$
Operating income	17,258	29,202	88,774	106,171
Depreciation and amortization <sup>(1)</sup>	16,003	18,402	70,312	72,509
EBITDA	33,261	47,604	159,086	178,680
EBITDA margin (%) <sup>(2)</sup>	9.5	12.1	10.8	10.9
EBITDA	33,261	47,604	159,086	178,680
Non-operating expenses, net of goodwill impairment loss	(2,111)	(4,787) <sup>(3)</sup>	(6,403)	(13,335) <sup>(3)</sup>
Maintenance capital expenditures <sup>(4)</sup>	(4,407)	(5,399)	(13,417)	(20,661)
Distributable cash	26,743	37,418	139,266	144,684

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

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

(3) Excludes goodwill impairment loss of \$153.2 million.

(4) 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:

	Three months ended December 31,		Year ended December 31,	
	2009	2008	2009	2008
(expressed in thousands of Canadian dollars)	\$	\$	\$	\$
Cash flows from operating activities	12,910	32,637	130,089	155,088
Maintenance capital expenditures, net of gain on disposal	(3,847)	(5,225)	(11,481)	(20,479)
Standardized distributable cash	9,063	27,412	118,608	134,609
Change in non-cash operating working capital <sup>(1)</sup>	17,824	14,183	18,898	18,938
Amortization of prepaid aircraft rent and related fees <sup>(1)</sup>	(482)	(482)	(1,929)	(1,928)
Unit based compensation <sup>(1)</sup>	(480)	(770)	(1,917)	(3,074)
Funding of unit based compensation, net of forfeitures <sup>(1)</sup>	–	20	2,050	1,831
Accretion of debt component of convertible debentures	(134)	–	(134)	–
Foreign exchange gain (loss) <sup>(1)</sup>	326	(2,748)	2,843	(4,090)
Unrealized gain (loss) on Asset Backed Commercial Paper (“ABCP”) <sup>(1)</sup>	650	–	650	(2,985)
Other <sup>(1)</sup>	(24)	(197)	197	1,383
Distributable cash	26,743	37,418	139,266	144,684
Distributions declared	18,429	30,888	102,787	123,552
Payout ratio – distributions declared/standardized distributable cash	203.3%	112.7%	86.7%	91.8%
Payout ratio – distributions declared/distributable cash	68.9%	82.5%	73.8%	85.4%
<b>Cumulative – since IPO<sup>(2)</sup></b>				
Standardized distributable cash			552,170	433,562
Distributable cash			561,175	421,909
Distributions declared			448,100	345,313
Standardized distributable cash payout ratio			81.2%	79.6%
Distributable cash payout ratio			79.9%	81.8%

(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.

	Three months ended December 31,		Year ended December 31,	
	2009	2008	2008	2007 <sup>(1)</sup>
(expressed in thousands of Canadian dollars)	\$	\$	\$	\$
Cash flows from operating activities	12,910	130,089	155,088	143,767
Adjusted net income <sup>(2)</sup>	23,195	121,994	134,936	150,654
Cash distributions declared relating to the period	18,429	102,787	123,552	123,552
Excess (shortfall) of cash flows from operating activities over cash distributions declared	(5,519)	27,302	31,536	20,215
Excess of adjusted net income <sup>(2)</sup> over cash distributions declared	4,766	19,207	11,384	27,102
<b>Payout ratios</b>				
Distributions declared/cash flows from operating activities	142.7%	79.0%	79.7%	85.9%
Distributions declared/adjusted net income <sup>(2)</sup>	79.5%	84.3%	91.6%	82.0%

(1) 2007 results presented for comparative purposes are those of the Partnership.

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

The shortfall of cash flows from operating activities over cash distributions have been funded through working capital management or cash on hand.

Cash from operating activities can fluctuate from period to period, effected by, among other factors, changes in Billable Block Hours, non-cash working capital balances, and foreign exchange rates. As a result, Jazz takes a more long-term view and considers the amount of cash

generated by the business in determining the amount of distributions to its unitholders. In general, fluctuations in quarterly working capital are not taken into consideration as these tend to be temporary in nature and can change quite significantly from one period to another.

These quarterly shortfalls do not represent an economic return of capital, and have had no impact on the covenants under the Credit Facilities. Jazz maintains adequate cash balances to manage these non-cash working capital fluctuations while delivering cash distributions and complying with debt covenants.

## 7. QUARTERLY FINANCIAL DATA

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

	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009	Q4 2009
Operating revenue (\$000)	396,361	409,805	437,439	392,684	369,434	373,569	379,659	351,238
Operating expenses (\$000)	362,004	380,988	392,069	352,957	337,823	336,855	344,893	325,932
Amortization of CPA Asset (\$000)	10,525	10,525	10,525	10,525	10,525	10,525	10,525	8,048
Operating income (\$000)	23,620	18,504	34,845	29,202	21,086	26,189	24,241	17,258
Total non-operating								
income (expense) (\$000)	(4,061)	(1,391)	(3,096)	(158,017) <sup>(1)</sup>	(1,961)	(811)	(1,520)	(2,111)
Net income (loss) (\$000)	21,765	23,569	31,749	(86,493)	21,123	25,378	25,321	20,816
Adjusted net income <sup>(2)</sup> (\$000)	30,296	27,426	42,274	34,940	29,650	35,903	33,246	23,195
Controllable Costs (\$000)	203,952	209,009	203,408	203,093	218,930	219,504	216,216	202,480
Billable Block Hours	105,347	100,860	106,325	98,232	95,541	98,410	100,486	91,783
Revenue Passenger Miles (000's)	1,045,289	1,045,842	1,074,929	937,993	863,315	947,206	997,751	850,075
Available Seat Miles (000's)	1,412,000	1,423,318	1,502,652	1,319,052	1,269,475	1,408,433	1,449,292	1,265,084
Passenger Load Factor (%)	74.0	73.5	71.5	71.1	68.0	67.3	68.8	67.2
Cost per Available Seat Mile (CASM) (¢)	25.64	26.77	26.09	26.76	26.61	23.92	23.80	25.76
CASM, excluding fuel expense (¢)	19.04	18.67	17.29	19.98	22.09	19.51	18.85	20.65
Controllable CASM (¢)	14.44	14.68	13.54	15.40	17.25	15.58	14.92	16.01
Controllable Adjusted Actual Margin (%)	12.9	10.5	16.7	14.9	11.0	12.7	11.8	9.0
EBITDA (\$000)	41,194	37,093	52,789	47,604	39,071	44,278	42,476	33,261
Distributable cash (\$000)	32,669	30,302	44,295	37,418	33,989	40,619	37,915	26,743
Distributable cash per unit (\$)	0.27	0.25	0.36	0.31	0.28	0.33	0.31	0.22
Distributions declared per unit (\$)	0.25	0.25	0.25	0.25	0.25	0.25	0.19	0.15
Net income (loss) per unit,								
basic in accordance with GAAP								
– Jazz (\$)	0.18	0.19	0.26	(0.71)	0.17	0.21	0.21	0.17
Net income per unit,								
basic in accordance with GAAP								
– Partnership (\$)	0.25	0.22	0.35	0.28	n/a	n/a	n/a	n/a
Adjusted net income <sup>(2)</sup> per unit, basic (\$)	0.25	0.22	0.35	0.29	0.24	0.29	0.27	0.19

(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 goodwill impairment loss. This is a non-GAAP measurement.

## 8. LIQUIDITY AND CAPITAL RESOURCES

The recent global financial crisis has tightened liquidity in the financial markets and has affected investor confidence in global equity markets, leading to significant declines in global market indices and negatively impacting the value of publicly-traded securities of many companies. Management has evaluated aspects of Jazz's business and financial condition that could be affected by these conditions as they currently exist, including maturity of its Credit Facilities. As at the date of this report, no material adverse consequences with respect to its liquidity have occurred. (Refer to Section 17 – Risk Factors.)

Jazz continues to generate positive operating income and cash flows from operations. At December 31, 2009, Jazz had \$223.6 million in cash and cash equivalents on hand, representing an increase of \$91.7 million or 69.5% from December 31, 2008 (refer to discussion below on convertible debentures). Despite the difficult credit market conditions, Jazz currently maintains the ability to generate sufficient cash flow to fund cash distributions (which are at the discretion of the Board), planned capital expenditures and to service its debt obligations. (Refer to Caution regarding forward-looking information.)

### Summary of Cash Flows

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

	Three months ended December 31,		Year ended December 31,	
	2009	2008	2009	2008
(expressed in thousands of Canadian dollars)	\$	\$	\$	\$
Cash provided by operating activities	12,910	32,637	130,089	155,088
Cash provided by (used in) financing activities	63,195	(31,543)	(27,344)	(125,817)
Cash used in investing activities	(3,847)	(5,225)	(11,062)	(20,269)
Net change in cash and cash equivalents during the periods	72,258	(4,131)	91,683	9,002
Cash and cash equivalents – Beginning of periods	151,301	136,007	131,876	122,874
Cash and cash equivalents – End of periods	223,559	131,876	223,559	131,876

### Operating activities

Jazz continued to generate positive cash flows from operations of \$12.9 million and \$130.1 million for the three months and year ended December 31, 2009, compared to \$32.6 million and \$155.1 million for the same periods in 2008. The decrease for the three months and year ended December 31, 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 months and year ended December 31, 2009 included distributions to unitholders of Jazz of \$18.4 million and \$106.9 million, respectively, and a repayment of obligations under capital leases of \$0.6 million and \$2.7 million, respectively. Cash provided by financing activities included \$82.3 million related to the issuance of convertible debentures (refer to discussion below on convertible debentures).

Cash used in financing activities for the three months and year ended December 31, 2008 included distributions to unitholders of Jazz of \$30.9 million and \$123.6 million, respectively and \$0.7 million and \$2.3 million, respectively, for repayment of obligations under capital leases.

### Investing activities

Investing activities for the three months and year ended December 31, 2009 included capital expenditures of \$4.4 million and \$13.4 million, respectively. Capital expenditures consisted of investments made to replenish aircraft rotatable parts and other purchases necessary to support the ongoing operations. Cash provided by investing activities for the year ended December 31, 2009 included the collection of a long-term receivable of \$0.4 million, and proceeds on disposal of property and equipment of \$1.9 million.

Investing activities for the three months and year ended December 31, 2008 included capital expenditures of \$5.4 million and \$20.7 million, respectively. Capital expenditures consisted of investments made to replace the maintenance information system, replenish aircraft rotatable parts, and other purchases necessary to support the ongoing operations. Cash provided by investing activities included the collection of a long-term receivable of \$0.2 million.

### Contractual obligations and other commitments

The table below summarizes for Jazz's principal cash debt repayments and future minimum lease payments under operating leases for flight equipment and base facilities that have initial or remaining non-cancellable terms in excess of one year for the years 2010 through to 2014 and thereafter.

(expressed in thousands of Canadian dollars)	Payments Due by Period						After 5 Years
	Total \$	2010 \$	2011 \$	2012 \$	2013 \$	2014 \$	
Term facility	115,000	115,000	–	–	–	–	–
Convertible debentures <sup>(1)</sup>	86,250	–	–	–	–	86,250	–
Capital leases	22,694	4,147	4,119	3,772	3,746	3,746	3,164
Operating leases							
Air Canada and its subsidiaries <sup>(2)</sup>	1,024,627	113,834	94,419	88,489	86,600	86,223	555,062
Operating leases							
Other third parties	64,938	12,764	9,168	5,865	4,863	4,455	27,823
	1,313,509	245,745	107,706	98,126	95,209	180,674	586,049

(1) Refer to "Convertible debentures" below for further discussion.

(2) Certain of the aircraft lease agreements have been entered into by Air Canada Capital Ltd. or Air Canada with head lessors and subleased to Jazz. These leases are included in the above table under the heading "Air Canada and its subsidiaries". For further discussion, refer to Section 10 – Economic Dependence.

(3) A significant portion of these lease payments are payable in US dollars.

In 2007 Jazz entered into a common terms agreement ("CTA") which governs two of Jazz's aircraft leases and which will also apply to any future aircraft leases with the same company. During the fourth quarter of 2009, Jazz renegotiated the terms of the leases for the two aircraft such that, the minimum cash balance covenant in the CTA is no longer applicable. Jazz was in compliance with the tangible asset disposal covenant contained within the CTA as at December 31, 2009.

### Long-term debt

As at December 31, 2009, Jazz had authorized Credit Facilities of \$150.0 million and drawings of \$115.0 million, against the facilities. In addition, letters of credit totaling approximately \$3.2 million (December 31, 2008 – \$3.4 million) were issued as security for groundhandling and airport fee contracts, lease payments on rental space and aircraft, and certain employee benefits.

The Credit Facilities were secured by substantially all the present and future assets of Jazz, and contained customary representations and warranties and were subject to customary terms and conditions (including negative covenants, financial covenants and events of default) for borrowings of this nature, including limitations on paying distributions.

The continued availability of the Credit Facilities was subject to Jazz's ability to maintain certain leverage, debt service and interest coverage covenants, as well as other affirmative and negative covenants. As at December 31, 2009, Jazz was in compliance with all conditions of the Credit Facilities.

The Credit Facilities matured on February 1, 2010 and all amounts owing thereunder were repaid and the related security was released. As a result, Jazz has all of its assets unencumbered (excluding \$3.3 million in cash encumbered in support of issued letters of credit) and available to support future debt financing. Jazz has suf-

ficient 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.

### Convertible debentures

On October 22, 2009, Jazz announced that it had entered into an agreement to sell to a group of underwriters \$75.0 million principal amount of 9.50% convertible unsecured subordinated debentures (the "Debentures"). This transaction closed on November 12, 2009. Jazz granted the underwriters an option, exercisable in whole or in part at any time until 30 days after the closing date, to purchase an additional \$11.25 million in principal amount of Debentures, at the same price. This option was exercised on November 25, 2009. The total gross proceeds of the financing was \$86.25 million. The net proceeds received by Jazz from the sale of Debentures was \$82.3 million after deduction of the underwriters' fee and the expenses of the offering. The underwriters' fee and the expenses of the offering are paid out of the gross proceeds of the offering. Proceeds from the offering will be used for working capital requirements and for general purposes of Jazz. This may include, among other uses, funding deposit amounts in respect of Jazz's refueling program, repaying outstanding indebtedness and funding possible future acquisitions. There are no agreements or understandings with respect to any of such possible uses of proceeds at this time. Jazz will retain broad discretion in allocating the net proceeds not applied in the manner set out above. Jazz's actual use of the net proceeds will vary depending on its operating and capital needs from time to time.

The Debentures 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), the earlier of the Maturity Date and the date fixed for redemption at a conversion price of \$5.25 per Unit (the "Conversion Price"). The Debentures are not redeemable on or before December 31, 2012, except on 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. The offering was made in all provinces and territories of Canada.

Upon issuance, for accounting purposes, the Debentures were separated into liability and equity components based on the respective estimated fair values at the date of issuance. The fair value of the liability component is estimated based on the present value of future interest and principal payments due under the terms of the Debentures using a discount rate for similar debt instruments without a conversion feature. The value assigned to the equity component is the estimated fair value ascribed to the holder's option to convert. Interest expense on the Debenture is determined by applying an effective interest rate to the outstanding liability component. The difference between actual cash interest accrued and interest expense is accreted to the liability component.

The following table allocates the Debentures between debt and equity:

(expressed in thousands of Canadian dollars)	Cost of borrowing	Debt \$	Equity \$	Total \$
Convertible debentures	9.5%	81,717	4,533	86,250
Transaction costs <sup>(1)</sup>		(3,776)	(209)	(3,985)
At issuance		77,941	4,324	82,265
Accretion expense		239	-	239
As at December 31, 2009		78,180	4,324	82,504

(1) Transaction costs are capitalized and offset with the debt and equity portions of the debentures and amortized into income over the life of the debentures using the effective interest method.

For the year ended December 31, 2009, total interest expense was \$1.3 million, which comprised of accrued interest of \$1.1 million and interest accretion of \$0.2 million.

## Units

As at December 31, 2009 and December 31, 2008, and as at the date of this report, February 9, 2010, Jazz had 122,864,012 Units issued and outstanding. The issuance of the convertible debentures discussed above creates 16,428,571 potentially dilutive units; as a result, if fully exercised, Jazz would have 139,292,483 units outstanding.

## Off balance sheet arrangements and guarantees

Jazz enters into real estate leases or operating agreements which grant a license to Jazz to use certain premises and/or operate at certain airports in most of the cities that it serves. It is common in such commercial lease transactions for Jazz, as the lessee, to agree to indemnify the lessor and other related third parties for tort liabilities that arise out of or relate to Jazz's use or occupancy of the leased or licensed premises. In certain cases, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but generally excludes any liabilities caused by their gross negligence or willful misconduct. Jazz also typically indemnifies such parties for any environmental liability that arises out of or relates to its use or occupancy of the leased or licensed premises.

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

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

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

The maximum amount payable under the foregoing indemnities cannot be reasonably estimated. Jazz carries or is otherwise the beneficiary of various insurance policies in respect of various risks

applicable to the business (including in respect of tort liability and certain contractual indemnities). Jazz expects that it would be covered by insurance for most tort liabilities and certain related contractual indemnities described above.

### Capital expenditures

Capital expenditures are incurred by Jazz to maintain, replace and add to its existing capital assets. Jazz separates its capital expenditures into three categories: leasehold improvements, (which include improvements made to leased aircraft) aircraft related (includes aircraft related communication, equipment and tooling, aircraft rotatable parts and engines), and facilities and owned buildings.

For the year ended December 31, 2009, capital expenditures were \$13.4 million (2008 – \$20.7 million), which consisted of investments made to replenish aircraft rotatable parts and other purchases necessary to support the ongoing operations. Capital spend was lower than expected in 2009, primarily from a curtailment of spending due to the uncertainty surrounding Air Canada's financial position and the composition of Jazz's operating fleet under the CPA. In addition, 2008 capital expenditures included investments made to replace the maintenance information system. Management anticipates capital expenditures for the year ended December 31, 2010 to be \$20.0 million (refer to caution regarding forward looking information).

## 9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Jazz's financial instruments consist of cash and cash equivalents, accounts receivable, ABCP, accounts payable and accrued liabilities, obligations under capital leases, long-term debt and convertible debentures.

Jazz, through its financial assets and liabilities, 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 December 31, 2009, Jazz's investments consisted of bankers acceptances and bankers deposit notes issued by four schedule 1 banks and one R-1 high rated schedule 2 bank as well as a fully cashable GIC issued by a Schedule 1 bank. Jazz is exposed to interest rate fluctuation risk as a result of variable interest rates on its long-term debt. Jazz uses interest rate swaps to hedge its exposure to changes in interest rates, swapping its credit facility variable interest rate payments for fixed interest rate payments. Jazz has elected to designate its interest rate swaps as cash flow hedges and currently has no intention of settling these contracts early. Jazz entered into interest rate swap agreements with a third party in respect of \$115.0 million of debt which has effectively resulted in a fixed interest rate of 5.98% until February 2, 2010. If Jazz had settled these contracts at December 31, 2009, a payment of \$0.8 million by Jazz would have resulted.

A 1% change in the interest rate would not have a significant impact on the net income of Jazz.

### 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 on cash and cash equivalents 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 during the third quarter of 2007 to prohibit investment in all third party and bank sponsored ABCP. With respect to investments in ABCP, refer to discussion below.

The amount of accounts receivable disclosed in the balance sheet of \$59.0 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 \$53.3 million of 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, as well as to demonstrate compliance with liquidity covenants included in financing contracts. 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.

### 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 its services within 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 which is used to pay down US denominated liabilities

and replenishes the balance through US denominated revenues. The amount of US dollar denominated assets was \$63.1 million and US denominated liabilities was \$59.7 million at December 31, 2009.

### Asset backed commercial paper

On January 21, 2009, the ABCP committee announced that the third-party ABCP restructuring plan had been implemented. Pursuant to the terms of the plan, holders of the ABCP had their short-term commercial paper exchanged for longer-term notes with maturities to match those of the assets previously contained in the underlying conduits.

As a result of the restructuring, at December 31, 2009, included in other assets is US dollar denominated, Master Asset Vehicle 3 (MAV3) Ineligible Asset Tracking Notes (the "Notes"). Jazz holds two Notes which were converted from ABCP under the restructuring

plan. Since conversion a principal repayment of \$0.9 million US has been received and as a result the face value of the notes held is \$4.6 million US. The notes, which track the performance of the underlying assets, have maturity dates of December 2021 and December 2027, and have been classified as held for trading.

The current carrying value of the Notes is \$1.1 million, which includes a fair value loss of \$3.9 million recorded in prior periods and a fair value recapture of \$0.7 million in the year ended December 31, 2009. All interest received on the Notes has been applied against the fair value. Since there is no active market for the Notes, Jazz calculated the fair value by discounting the expected future cash flows according to the probability of recovery of principal and interest based on maturity dates. There is a significant amount of uncertainty associated with estimating the timing of cash flows and fair value of the Notes.

## 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.

Pursuant to the terms of the CPA, Jazz and Air Canada agreed to re-set detailed rates (subject to the terms of the contract, including the controllable target margin requirements specified above) 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 next three-year period (2009 to 2011, inclusive). The new rates which were retroactive to January 1, 2009, were established so as to achieve a controllable target margin of 14.32% for Jazz (for the years 2006 to 2008, the target margin was 14.09%), excluding incentive and pass-through revenue, and before the deduction of incentive compensation expense paid to employees as a result of performance achievements on the CPA services provided to Air Canada. The percentage mark-up on Jazz's Controllable Costs for each of the years 2009 to 2011 was set at 16.72% (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 formally reflect certain amendments to the CPA, including the following.

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 upon 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 Jazz's 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 estab-

lished for the rate period commencing January 1, 2009 and ending on December 31, 2011 (the "2009-2011 Rate Period"). The Rates negotiated and reflected in the Rate Amending Agreement were established to enable Jazz to achieve a Controllable Target Margin of 14.32%, corresponding to a Controllable Target 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 commencing August 1, 2009, an agreed set of revised Rates became effective, under which Jazz achieves a Controllable Target Margin of 11.11%, excluding incentive and pass-through revenue, and before the deduction of incentive compensation expense paid to employees as a result of performance achievements on the CPA services provided to Air Canada, corresponding to 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. Rates for each rate period are determined pursuant to 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 type to be considered in developing each new Rate are set out in the schedules to the CPA and are based on costs incurred by Jazz. The CPA also specifies that the Rates are to be established so as to enable Jazz to achieve the Controllable Target Margin which corresponds to the Controllable Mark-Up. If Jazz and Air Canada can not 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 lost margin due to the reduction in flying. If, on the other hand, the Annual Delivered Block Hours are greater than 375,000 Block Hours, the Controllable Mark-Up of 12.50% shall 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 had 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 have 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, 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 by 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 shall commence with the return of eight CRJ 200 and two CRJ 100 aircraft upon the expiry of the subleases for such aircraft. Following the return of these aircraft the fleet of Covered Aircraft shall be temporarily reduced to 123 aircraft.

Jazz currently intends to acquire new, large turboprop aircraft with delivery of one aircraft per month commencing in May 2011. 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 five 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"). If an agreement is reached, Air Canada may commence the use of such Swing Aircraft to operate Scheduled Flights commencing

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 99.2% of Jazz's operating revenues for each of the years ended December 31, 2009 and 2008, respectively. Approximately 14.9% and 13.7% of Jazz's operating expenses for the years ended December 31, 2009 and 2008, 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:

	2010	2011	2012	2013	2014
(expressed in thousands of Canadian dollars)	\$	\$	\$	\$	\$
Defined benefit pension plans, current service	8,800	9,100	9,300	9,400	9,500
Defined benefit pension plans, past service	8,300	5,100	5,500	5,700	5,900
Defined contribution pension plans	8,200	8,200	8,100	8,200	8,400
Projected pension funding obligations	25,300	22,400	22,900	23,300	23,800

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, 2009 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, 2009 actuarial valuation for that plan.

The January 1, 2009 actuarial valuation for the Jazz pilot's registered plan reflects a change in the solvency asset valuation being used. Previous valuations used market value of assets, whereas the current valuation 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.

On June 12, 2009 the Solvency Funding Relief Regulations were enacted by the Government of Canada. Jazz has elected to implement funding relief measures available under such regulations such that the amortization period applicable to the January 1, 2009 solvency deficiency in Jazz's pilots' registered plan is increased from five years to ten years. This had the effect of reducing the 2009 minimum contributions by approximately \$1.8 million. The continuation of such extended amortization period beyond 2009 is conditional on obtaining a letter of credit or member consent. To the extent that the letter of credit or member consent is not obtained, Jazz must amortize the remaining deficiency over a five year period commencing January 1, 2010 and ending December 31, 2014. The current projection set out in the above table assumes that no member consent or a letter of credit is obtained and therefore the deficiency will be amortized over five years starting 2010.

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.)

## 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). The significant accounting policies of Jazz are described in note 2 of the December 31, 2009 consolidated financial statements of Jazz Air Income Fund.

### Future income taxes

Under the provisions of Bill C-52, Budget Implementation Act, 2007, which received Royal Assent on June 22, 2007, Jazz, as a publicly traded income trust, is considered a specified investment flow-through and will become subject to income taxes commencing January 1, 2011. Prior to 2011, Jazz continues to qualify for special income tax treatment that permits a tax deduction by Jazz for distributions paid to its unitholders. For accounting purposes, Jazz has computed future income tax based on temporary differences at the substantively enacted tax rate expected to apply when the temporary differences are expected to reverse. For periods prior to January 1, 2011, Jazz has not recognized any current income taxes or future income tax assets or liabilities on temporary differences expected to reverse prior to 2011 as the Trust is committed to distribute to its unitholders all or virtually all of its taxable income that would otherwise be taxable in Jazz. Based on substantively enacted tax rates in effect at December 31, 2009, Jazz is applying a tax rate of 28.4% for 2011 and 26.9% for 2012 and subsequent years.

The future income tax provision reflects the impact of the new legislation and the tax rate changes and accounts for the entire difference between the amount of the future income tax provision and the statutory income tax dollar amount of \$nil.

The tax effects of temporary differences that give rise to significant portions of the future income tax assets and future income tax liabilities at December 31, 2009, that are expected to reverse after 2010, are presented below:

	As at December 31,	
	2009	2008
(expressed in thousands of Canadian dollars)	\$	\$
<b>Future income tax assets</b>		
Property and equipment – differences in net book value and undepreciated capital cost	7,862	–
Deferred lease inducements	10,282	10,701
Other	1,068	3,529
	<b>19,212</b>	14,230
<b>Future income tax liabilities</b>		
Intangibles	32,506	31,856
Property and equipment – differences in net book value and undepreciated capital cost	–	5,935
	<b>32,506</b>	37,791
<b>Net future income tax liability</b>	<b>13,294</b>	23,561
<b>Income tax (recovery) expense is comprised of:</b>		
Future income tax recovery, exclusive of the effects of other components below	(8,921)	(8,080)
Future income tax recovery resulting from impairment of goodwill	–	(42,904)
Future income tax recovery related to the change in the taxation rate	(1,346)	–
<b>Net future income tax recovery</b>	<b>(10,267)</b>	(50,984)

### Employee future benefits

The significant policies related to employee future benefits, consistent with Section 3461, "Employee Future Benefits" of the CICA Handbook relating to Jazz's defined benefit pension plan for its pilots, the supplemental executive retirement plan for Jazz executives, and the Other Employee Future Benefits are as follows:

- The cost of pensions earned by employees is actuarially determined using the projected benefit method prorated on service, market interest rates, and management's best estimate of expected plan investment performance, salary escalation and retirement ages of employees. Obligations are attributed to the period beginning on the employee's date of joining the plan and ending on the earlier of the date of termination, death or retirement.
- The cost of the Other Employee Future Benefits is actuarially determined using the projected benefit method prorated on service (where applicable), market interest rates, and management's best estimate of retirement ages of employees, health care cost inflation, salary escalation and general inflation.

- The expected return on plan assets is based on the long-term expected rate of return on plan assets and the fair value of the plan assets. It is reasonably possible that management's estimate of the long-term rate of return may change as management continues to assess future investments and strategies and as a result of changes in financial markets.
- Past service costs arising from plan amendments of the defined benefit pension plan and the supplemental executive retirement plan are amortized on a straight-line basis over the average remaining service period of employees active at the date of the amendment. This period is currently 19 years for the pension plan and 14 years for the supplemental executive retirement plan.
- Cumulative unrecognized net actuarial gains and losses of the defined benefit pension plan and the supplemental executive retirement plan in excess of 10% of the greater of the accrued benefit obligation and the market value of plan assets at the beginning of the year are amortized over the average remaining service periods of active members expected to receive benefits under the plan (currently 19 years for the pension plan and 14 years for the supplemental executive retirement plan).
- The fiscal year-end date is December 31 and the measurement date of the plan's assets and obligations is December 31. Pension obligations are attributed to the period beginning on the employee's date of joining the plan and ending on the earlier of the date of termination, death or retirement. The obligations for the Other Employee Future Benefits plans are attributed to the period beginning on the employee's date of joining the plan or disablement (whichever applicable) and ending on the earlier of retirement or end of disablement or age 65 (whichever applicable).

The following assumptions were used in valuing the benefit obligations under the plan and the employer's net periodic pension or benefit cost:

- The discount rate used to determine the pension and benefit obligation was determined by reference to market interest rates, as of the measurement date, on high quality debt instruments with cash flows that approximately match the timing and amount of expected benefit payments. It is reasonably possible that these rates may change in the future as a result of changes in market interest rates.
- Jazz's expected long-term rate of return on assets assumption is based on economic conditions as of the measurement date and the specific portfolio mix of plan assets. Management, in conjunction with its actuaries, reviews anticipated future long-term performance of individual asset categories and considers the asset allocation strategy adopted by Jazz. These factors are used to determine the average rate of expected return on the funds invested to provide for the pension plan benefits. While the review considers recent fund performance and historical returns, the assumption is primarily a long-term, prospective rate. This assumption may change as management continues to assess future investments and strategies and as a result of changes in financial markets.

- The health care inflation used to determine the Other Employee Future Benefits costs is determined from recent industry experience combined with long-term expectations. The weighted average health care inflation assumption used for the health care plans is 6.47% per annum grading down to 4.5% per annum in and after 2012.
- Actual experience that differs from assumptions made by management will result in a net actuarial gain or loss, consequently increasing or decreasing the pension or benefit expense for future years. In accordance with Canadian GAAP, this difference is not recognized immediately as income or expense, but rather is amortized into income over future periods.

	Fiscal year ended December 31,	
	2009	2008
<b>Weighted average assumptions used to determine accrued benefit obligation</b>		
Discount rate	6.8	7.1
Rate of compensation increase	4.0 – 5.0	4.0 – 5.0
Health care inflation – Select	7.9	6.5
Health care inflation – Ultimate	4.3	4.5
Year ultimate trend reached	2012	2012
<b>Weighted average assumptions used to determine pension and benefit costs</b>		
Discount rate	7.1	5.6 - 5.8
Expected long-term rate of return on assets	7.1	6.4
Rate of compensation increase	4.0 – 5.0	4.0 – 5.0
Health care inflation – Select	6.5	7.1
Health care inflation – Ultimate	4.5	4.5
Year ultimate trend reached	2012	2012

### Intangibles

Intangible assets with finite lives are carried at their cost, net of amortization; while assets with indefinite lives are not amortized and are reviewed annually for impairment.

The CPA Asset has a finite life, is carried at cost and amortized over the initial term of the CPA plus renewal periods.

In the fourth quarter of 2009, Jazz changed its estimate of the useful life of the CPA intangible asset to coincide with the extended term of the CPA provided under the CPA Amending Agreement. This change has been applied prospectively. The change had the effect of decreasing amortization by \$2.5 million for the year ended December 31, 2009.

Goodwill represents the excess of the acquisition cost of companies over the fair value of the identifiable net assets acquired and is not amortized. At December 31, 2008, Jazz determined its goodwill was fully impaired and recorded a write-down of \$153.2 million.

### Property and equipment

Property and equipment was originally recorded at cost. As at December 31, 2009 the net book value of Jazz's property and equipment was \$203.0 million.

Property and equipment are depreciated to estimated residual values based on the straight-line method over their estimated service lives. Aircraft and flight equipment are depreciated over 20 to 30 years, with 5 – 20% estimated average residual values. Improvements to owned aircraft are capitalized and amortized over the remaining service life of the aircraft. Improvements to aircraft on operating leases are amortized over the term of the lease.

Buildings are depreciated over their useful lives not exceeding 40 years on a straight-line basis. An exception to this is where the useful life of the building is greater than the term of the land lease. In these circumstances, the building is depreciated over the life of the lease. Leasehold improvements are amortized over the lesser of the lease term or five years. Ground and computer equipment are depreciated over five years.

Aircraft depreciable life is determined through economic analysis, a review of existing fleet plans and comparisons to other airlines operating similar fleet types. Residual values are estimated based on Jazz's historical experience with regards to the sale of both

aircraft and spare parts, as well as future based valuations prepared by independent third parties.

Property under capital leases and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of fair value of the property or equipment and the present value of those lease payments. Property and equipment under capital leases are depreciated to estimated residual values over the life of the lease.

Property and equipment is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be used is measured by comparing the net book value of the asset to the undiscounted future cash flows expected to be generated by the asset. An impairment is recognized to the extent that the carrying amount exceeds the fair value of the asset.

### Aircraft leases

Jazz has significant lease and sublease obligations for aircraft that are classified as operating leases and are not reflected as assets and liabilities on its balance sheet. In accordance with GAAP, tests were performed to determine the operating lease classification. Jazz's aircraft leases do not include any residual value guarantees.

## 13. ACCOUNTING POLICY CHANGES AND DEVELOPMENTS

### Changes in accounting policies

#### GOODWILL AND INTANGIBLE ASSETS

In February 2008, the Canadian Accounting Standards Board ("AcSB") issued Section 3064, "Goodwill and Intangible Assets", to replace Section 3062, "Goodwill and Other Intangible Assets". This new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets by profit-oriented enterprises. The adoption of this new section had no impact on Jazz's consolidated financial statements.

#### FINANCIAL INSTRUMENTS

In June 2009, the AcSB issued amendments to Section 3862, "Financial Instruments – Disclosures", to require enhanced disclosures about the relative reliability of the data, or "inputs", that an entity uses in measuring the fair values of its financial instruments. The new requirements are effective for annual financial statements for fiscal years ending after September 30, 2009.

#### CREDIT RISK AND FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

On January 20, 2009, the Emerging Issues Committee ("EIC") of the Canadian Accounting Standards Board issued EIC Abstract 173, Credit Risk and Fair Value of Financial Assets and Financial Liabilities, which establishes guidance requiring an entity to consider its own credit risk as well as the credit risk of the counterparty in determining the fair value of financial assets and financial liabilities,

including derivative instruments. This interpretation must be applied retrospectively without restatement of prior years. The adoption of this interpretation did not have a significant impact on Jazz's consolidated financial statements.

### Change in accounting estimate

In the fourth quarter of 2009, Jazz changed its estimate of the useful life of the CPA intangible asset to coincide with the extended term determined under the CPA Amending Agreement. This change has been applied prospectively. The change in the basis of amortization had the effect of decreasing amortization by \$2.5 million for the year ended December 31, 2009.

### 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 Jazz will be required to prepare IFRS financial statements for the interim periods and fiscal year ends beginning in 2011. Jazz has created an implementation team, which consists of internal resources and an external consultant. A change-over 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 involved performing a high level impact assessment to identify key IFRS areas that are likely to affect Jazz. Each accounting standard



was reviewed under IFRS and was ranked as high, medium or low priority based on the differences from Canadian GAAP. Also, all relevant employees and board members were made aware of the changeover and the relevant timelines. Jazz 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 analysis performed, the major differences between Canadian GAAP and IFRS that are likely to impact Jazz 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 Jazz 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.

There is a paragraph under IAS 19, as interpreted by International Financial Reporting Interpretations Committee (“IFRIC”) 14, which imposes a limit on a balance sheet asset in respect of a funded defined benefit plan. The intent is to ensure that the balance sheet asset is limited to the amount recoverable by Jazz in future periods through surplus refunds or contribution holidays. IFRIC 14 may also create an “additional liability” related to Jazz’s past service funding contribution requirements for a funded defined benefit plan. The impact of IFRIC 14 may be significant, in particular, in respect of the pilot pension plan, and the impact may change significantly from one year to the next. Any such IFRIC 14 impact on the pilot plan as at the transition date will be recognized as an adjustment to Jazz’s retained earnings.

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, Jazz does not believe any significant changes to its financial reporting system will be necessary to facilitate the change-over.

#### **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 December 31, 2009, Jazz's operating fleet was made up of 134 operating aircraft, of which 70 were regional jets and 64 turboprop aircraft.

Jazz's operating fleet, at December 31, 2009, was as described below:

	Number of Operating Aircraft	Average Age of Operating Aircraft	Owned	Capital Lease	Operating Lease	Number of Operating Aircraft December 31, 2008
Canadair Regional Jet CRJ100	24	14.2	–	–	24	24
Canadair Regional Jet CRJ200	30	7.7	–	–	30	33
Canadair Regional Jet CRJ705	16	4.4	–	–	16	16
De Havilland DHC-8-300	28	19.2	19	7	2	28
De Havilland DHC-8-100	36	21.7	29	–	7	36
Total Operating Aircraft	134 <sup>(1)</sup>	14.6	48	7	79	137

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

All aircraft in Jazz's operating fleet as of December 31, 2009 are Covered Aircraft under the CPA, except for two Dash 8-100 and two Dash 8-300 aircraft allocated for charter purposes.

## 15. CONTROLS AND PROCEDURES

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

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

An evaluation of the design and effectiveness of the operation of Jazz's disclosure controls and procedures has been conducted by management, under the supervision of the CEO and CFO. Based on this evaluation, the CEO and CFO have concluded that, as of December 31, 2009, Jazz's disclosure controls and procedures, as defined by National Instrument 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings, are effective to ensure that information required to be disclosed in reports that are filed or submitted under Canadian securities legislation is recorded, processed, summarized and reported within the time periods specified therein.

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.

Management, under the supervision of the CEO and CFO, has evaluated the effectiveness of our internal control over financial reporting using the framework designed as described above. Based on this evaluation, the CEO and CFO have concluded that internal control over financial reporting was effective as of December 31, 2009.

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 that occurred during the year ended 2009 that has materially affected, or is reasonably likely to materially affect, Jazz's or the Partnership'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 consolidated financial statements of Jazz for December 31, 2009, 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.

Based on the 2009 and 2010 winter schedule and 2010 planning assumptions received from Air Canada, Jazz anticipates billing between 370,000 and 380,000 Block Hours for the year ending December 31, 2010.

Effective August 1, 2009, Jazz and Air Canada have agreed to reduce the current mark up on Controllable Costs from 16.72% to 12.50% for the remainder of the CPA contract. Based on this change and the anticipated Billable Block Hours for 2010, Jazz projects the CPA Controllable Operating Margin for 2010 to be from 8.25% to 9.25%, with some quarterly fluctuations above and below the annual range depending on Jazz's operational seasonality.

## 17. RISK FACTORS

### Risks Relating to the Relationship with Air Canada

#### DEPENDENCE ON AIR CANADA

Jazz is directly affected by the financial and operational strength of Air Canada and its competitive position. In the event of any decrease in the financial or operational strength of Air Canada, Jazz's ability to receive payments from Air Canada, and the amount of such payments, may be adversely affected. In addition, if Air Canada's competitive position is materially weakened, it could affect the utilization of the Covered Aircraft.

In the recent past, Air Canada has, like other network carriers, sustained significant operating losses and may sustain significant losses in the future. Air Canada's business, results from operations and financial condition are subject to a number of risks, including:

- Air Canada has substantial commitments for capital expenditures, including for the acquisition of new aircraft;
- fuel costs, which continue to fluctuate and recently reached historically high levels, constitute a significant portion of Air Canada's operating expenses;
- labour conflicts or disruptions can have a material adverse effect on Air Canada's business, results from operations and financial condition;
- the airline industry is highly competitive and subject to price discounting; and
- the risk factors described under "Risks Relating to the Industry".

Air Canada is the sole marketing agent for Jazz's Covered Aircraft capacity and is solely responsible for establishing schedule, routes, frequency and ticket prices for Jazz. To the extent Air Canada does not effectively and competitively market the routes serviced through Jazz, the utilization of the Covered Aircraft could be reduced with the result that Jazz's operating margin in dollar terms would be reduced.

In addition, Air Canada is responsible for establishing Jazz's operating plans for the Covered Aircraft, including schedules, Block Hours, departures, ASMs and load factors for each aircraft type included in the Covered Aircraft, and any changes thereto. Should such operating plans not be provided to Jazz on a timely basis in accordance with the CPA, Jazz's operations could be materially adversely affected.

#### LIQUIDITY ISSUES

Air Canada has significant ongoing capital and liquidity requirements. On October 27, 2009, Air Canada completed a public offering of

Units for aggregate gross proceeds in the amount of \$249 million. Based on public filings, Air Canada intends to use the proceeds for working capital and general corporate purposes. On July 29, 2009, Air Canada announced that it had entered into arrangements for a term credit facility for up to \$700 million. In addition, on July 24, 2009 the Minister of Finance advised Air Canada of a regulation that had been approved to amend Air Canada's funding obligations to permit a moratorium on past service contributions for a 21 month period. There can be no assurance that these measures will provide Air Canada with sufficient liquidity to continue operations in the longer term. On October 27, 2009, Air Canada announced that it had completed the closing of its bought deal public offering pursuant to which it sold to an underwriting syndicate 160,500,000 units for aggregate gross proceeds to Air Canada of \$260.0 million (net proceeds of approximately \$249.6 million after deduction of the underwriting fees).

The failure of Air Canada to satisfy its liquidity requirements could have a material adverse effect on Jazz's business, results from operations and financial condition. Such material adverse effect could result in the event of any inability of Air Canada to pay the fees owing to Jazz under the CPA or in any reduction in the utilization of the Covered Aircraft.

#### TERMINATION OF THE CPA

Substantially all of Jazz's current revenues are received pursuant to the CPA with Air Canada which currently covers all of Jazz's existing operating fleet (except four Dash 8 aircraft as of March 28, 2008). The CPA Amending Agreement extended the initial term of the CPA from December 31, 2015 to December 31, 2020. The CPA will be automatically renewed for two additional five year periods, unless either party gives notice to the other of its intention not to renew within one year prior to the expiry of the initial term or any renewal term. In addition, either party is entitled to terminate the CPA at any time upon the occurrence of an event of default. Events of default include, without limitation:

- bankruptcy or insolvency of the other party;
- suspension or revocation of Jazz's right to operate as a scheduled airline;
- failure by Air Canada or Jazz to pay amounts when due where such default continues for a period of 30 days after notice;
- failure by Air Canada or Jazz to comply with any of its obligations under the CPA, such default continues for a period of 30 days after notice;

- failure to operate more than 50% of the Covered Aircraft for more than seven consecutive days or failure to operate 25% of the Covered Aircraft for more than 21 consecutive days, other than as a result of an order of a governmental authority affecting the industry generally or as a result of any action by Air Canada, any strike by Air Canada employees or any force majeure (including any cessation, slow-down, interruption of work or any other labour disturbance);
- failure by Jazz to meet certain performance criteria;
- default by Jazz with respect to any material term, if such default continues for more than the allotted period of grace, if any;
- a default by Air Canada or Jazz with respect to a material term of any other material agreement between Jazz and Air Canada if such default continues for more than the allotted period of grace, if any;
- failure by Jazz to maintain adequate insurance; and
- failure by Jazz to comply with Air Canada's audit and inspection rights.

If the CPA is terminated, Jazz's revenue and earnings would be significantly reduced or eliminated unless Jazz is able to enter into satisfactory substitute arrangements. There is no assurance that Jazz would be able to enter into satisfactory substitute arrangements or that such arrangements would be as favourable to Jazz as the CPA.

Under the CPA, if a change of control of Jazz (other than in favour of the Fund) occurs without the consent of Air Canada, Air Canada may terminate the CPA. The existence of this right may limit Jazz's ability to negotiate or consummate the sale of all or part of its business to another entity or otherwise participate in any consolidation in the airline industry.

The CPA provides that upon the expiry or termination of the CPA, other than termination as a result of a default by Jazz or Air Canada, all leases between Jazz and Air Canada (or any affiliate of Air Canada) in respect of Covered Aircraft and spare engines shall automatically be terminated and Air Canada (or any affiliate of Air Canada) shall have the right to repossess the Covered Aircraft and the spare engines. There can be no assurance that Jazz will be able to find replacement aircraft in these circumstances. In the event that Jazz is able to find replacement aircraft, there can be no assurance that Jazz will be able to do so on terms as favourable as the terms of its current leases with Air Canada (or any affiliate of Air Canada). Unless Jazz is able to find replacement aircraft on reasonable terms, Jazz's ability to offer scheduled and charter flights to any carrier would be materially adversely affected, which would have a material adverse effect on Jazz's business, results from operations and financial condition.

In the event that the CPA is terminated as a result of Jazz's default, all leases between Jazz and Air Canada (or any affiliate of Air Canada) in respect of Covered Aircraft and spare engines will not be automatically terminated. In such event, Jazz would remain liable for its obligations under the aircraft leases with no corresponding ability to earn income under the CPA to cover its aircraft lease obligations, which would have a material adverse effect on Jazz's business, results from operations and financial condition.

The CPA Amending Agreement also provides Air Canada with the right to revise the MADUG 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 upon 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 Jazz's intention to either accept the revised MADUG or exercise its right to terminate the CPA as of December 31, 2016.

There can be no assurances that Jazz and Air Canada will, if required, agree to a revised MADUG or that, if the parties do not agree and Air Canada unilaterally sets a revised MADUG level, such revised MADUG level will be acceptable to Jazz. If the CPA is terminated, Jazz's revenue and earnings would be significantly reduced or eliminated unless Jazz is able to enter into satisfactory alternative business arrangements. There is no assurance that Jazz would be able to enter into satisfactory alternative business arrangements or that such arrangements would be as favourable to Jazz as the CPA. Any such termination, or failure to enter into satisfactory substitute arrangements, could have a material adverse effect on Jazz's business, results from operations and financial condition.

Upon the expiration or termination of the CPA, Jazz may lose access to airport facilities at key locations where Air Canada supplies facilities and other services to Jazz. Jazz may also lose access to such airport facilities should Air Canada not be able to secure such access to airport facilities in the future. Most of the airport facilities at Jazz's principal domestic destinations are leased by Air Canada from airport authorities. Under the CPA, Jazz is currently entitled to use these facilities to fulfill its obligations to Air Canada under the CPA. All of Jazz's airport takeoff or landing slots used for Scheduled Flights are under Air Canada's name. Upon the expiry or termination of the CPA, Jazz may lose access to those airport facilities, airport takeoff or landing slots and Jazz may have to enter into alternative arrangements to use the same or other airport facilities and slots at higher rates. There can be no assurance that Jazz would be able to have access to other airport facilities or slots or as to the terms upon which Jazz could do so. Jazz's inability to have appropriate access to sufficient airport facilities or slots or the possibility to do so with a significant cost increase would have a material adverse effect on Jazz's business, results from operations and financial condition.

#### REDUCED UTILIZATION LEVELS

While the CPA requires Air Canada to meet certain minimum utilization levels for Jazz's aircraft, Air Canada determines, in its sole discretion, which routes Jazz flies. If Air Canada was unable to find sufficient capacity for its own aircraft or was able to operate at a competitive cost compared to Jazz or use other suppliers at competitive cost, or for any other reason, Air Canada could reduce Jazz's flights to the minimum utilization levels or could require Jazz to fly its aircraft on routes that may under-utilize Jazz's aircraft capacity or may make it more difficult for Jazz to reach incentive targets and thus Jazz may earn less revenue under the CPA. Though Jazz would still be guaranteed a minimum revenue, if its aircraft were underutilized by Air Canada, Jazz would lose the ability to recover a margin on

the direct operating costs of flights that would otherwise have been realized had Jazz's aircraft been more fully utilized. Jazz would also lose the opportunity to earn incentive compensation. The minimum average daily utilization guarantee will not apply in the event Jazz fails to reach the minimum number of Block Hours due to its own default or an inability to supply sufficient capacity.

Pursuant to the terms of the CPA, Air Canada and Jazz have agreed that the MADUG will not be less than 339,000 annual Block Hours, including after having taken into account the reduction in the number of Covered Aircraft described in "Recent Developments – Amendments to the Capacity Purchase Agreement with Air Canada", subject to Air Canada's one-time right to revise the MADUG in the circumstances described above.

If Air Canada was unable to find sufficient capacity for its own aircraft or was able to operate at a competitive cost compared to Jazz or use other suppliers at competitive cost, or for any other reason, Air Canada could reduce Jazz's flights to the minimum utilization levels or could require Jazz to fly its aircraft on routes that may under-utilize Jazz's aircraft capacity or may make it more difficult for Jazz to reach incentive targets. Any such reduction or requirement would likely result in lower revenues earned by Jazz under the CPA, which could have a material adverse effect on Jazz's business, results from operations and financial condition.

#### **FORCE MAJEURE**

Air Canada's and Jazz's obligations under the CPA (other than any financial obligations) will be suspended if, and for so long as, any event of force majeure prevents a party from meeting its obligations pursuant to the CPA. In addition, Air Canada and Jazz recognize that an event of force majeure may inadvertently result in one party being in default of a collective agreement to which it is a party. As a result of any event of force majeure that occurs during the term of the CPA, Air Canada and Jazz may decide to renegotiate certain terms of the CPA, including, without limitation, rates for the payment of fees by Air Canada, minimum capacity purchase guarantees as well as certain elements of the then current three-year, annual or seasonal operating plans and the long range fleet plan, including Block Hours and departures, ASMs, airports to which Jazz will operate and the number of Covered Aircraft. Such changes to the terms of the CPA, whether temporary or long-term, could have a material adverse effect on Jazz's business, results from operations and financial condition.

#### **REPLACEMENT OF SERVICES PROVIDED BY AIR CANADA UNDER THE CPA AND THE MSA**

Air Canada provides a number of important services to Jazz, including ticket sales, reservations and call center services, designator codes, information technology, de-icing services and glycol usage, fuel purchasing services as well as passenger, aircraft and traffic handling services. If the CPA is not renewed beyond its original term or subsequent renewal terms, or is otherwise terminated, Jazz would either need to provide these services internally or contract with third parties for such services. There can be no assurance that Jazz would be able to replace these services on a cost effective or timely basis. In addition, pursuant to the MSA, 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. If the MSA is terminated, Jazz would either need to provide these functions internally or contract with third parties for such functions. There can be no assurance that Jazz would be able to replace these services on a cost-effective or timely basis. Jazz's inability to replace these services on a cost effective or timely basis could have a material adverse effect on Jazz's business, results from operations and financial condition.

#### **CHANGES IN COSTS AND FEES**

Jazz is paid fees by Air Canada on a variety of different metrics based on Jazz's estimated controllable costs for each calendar year in the applicable period marked-up by a specified percentage. Such mark-up equates to a specified margin on Jazz's estimated Scheduled Flights Revenue for each calendar year in the applicable period. Air Canada is responsible for scheduling and pricing the flights, and absorbs the risk of variations in ticket prices, passenger loads and fuel prices. If such controllable costs exceed Jazz's estimates, Jazz may realize decreased profits and even losses under the CPA, and may be unable to generate sufficient cash flow to pay its debts on time and Jazz may have to reduce its expansion plans. If any of these events occurs, Jazz's business, results from operations and financial condition could be materially adversely affected.

For the periods commencing 2009 and 2012, Jazz and Air Canada established and will establish rates for each of the succeeding three years. There can be no assurance that the estimates of the future costs used and to be used in negotiating such rate resets is and will be accurate.

The CPA Amending Agreement amended the Rates established for the 2009-2011 Rate Period. The Rates negotiated and reflected in the Rate Amending Agreement were established to enable Jazz to achieve a Controllable Target Margin of 14.32%, corresponding to a Controllable Target 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 commencing August 1, 2009, an agreed set of revised rates will be effective, enabling Jazz to achieve a Controllable Target Margin of 11.11%, corresponding to a Controllable Mark-Up of 12.50% on Jazz's Controllable Costs. If Controllable Costs exceed Jazz's estimates, Jazz may realize decreased profits and even losses under the CPA, and may be unable to generate sufficient cash flow to pay its debts on time and Jazz may have to reduce its expansion plans. If any of these events occurs, Jazz's business, results from operations and financial condition could be materially adversely affected.

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 lost margin due to the reduction in flying. If annual Delivered Block Hours are greater than 375,000 Block Hours, the Controllable Mark-Up of 12.50% shall 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.

The Controllable Mark-Up may also be reduced as a result of the 2009 Benchmark and 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, 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 by the results of the 2015 Benchmark, with effect as of January 1, 2016 until December 31, 2020. Any such reduction in the Controllable Mark-Up could have a material adverse effect on Jazz's business, results from operations and financial conditions.

#### **AIR CANADA PILOTS ASSOCIATION ("ACPA") SCOPE CLAUSES AND SMALL JETS SETTLEMENT AGREEMENT**

Air Canada's collective bargaining agreement with ACPA and the Small Jets Settlement Agreement entered into by Air Canada, Jazz, ACPA and the Air Line Pilots Association ("ALPA") limit the number of regional jet aircraft which can be operated by Jazz under the CPA. The Small Jets Settlement Agreement also prevents Jazz from operating the CRJ705 aircraft if configured in excess of 75 seats, inclusive of all classes, and sets out a minimum ratio of ASMs flown by Air Canada compared to the CPA ASMs flown by Jazz. These restrictions may cause Air Canada to reduce the level of capacity it purchases from Jazz under the CPA, prevent Jazz from expanding its market share, or impede Jazz's fleet development which could significantly reduce Jazz's expected growth, revenue and earnings. Jazz cannot ensure that any future Air Canada collective bargaining agreement will not contain similar, or more severe, restrictions for Jazz.

#### **CONSTRAINTS ON JAZZ'S ABILITY TO ESTABLISH NEW OPERATIONS**

Subject to regulatory restrictions, the CPA does not preclude Jazz from entering into capacity purchase agreements with, or providing airline services to, or making investments in, other carriers as long as Jazz's ability to perform its obligations under the CPA is not impaired as a result. However, if Jazz enters into an agreement with another carrier to provide regional airline services (other than charter flights), whether on a capacity purchase or other economic basis, Air Canada will have the right to reduce the number of Covered Aircraft, on a one-for-one basis, by the number of aircraft to be operated under such other agreement, thereby reducing Jazz's ability to earn revenue from Air Canada.

Jazz does not directly benefit from any order of, or option to purchase, regional jet aircraft. As a result, in the event that Jazz desires to enter into capacity purchase agreements with, or provide airline services to, carriers other than Air Canada, Jazz may not be able to

obtain in a timely manner the aircraft required to provide such services, unless Jazz is able to lease such aircraft or to obtain financing for such acquisition. There can be no assurance that Jazz's credit ratings will enable it to lease, or finance the acquisition of such aircraft, or do so at reasonable borrowing rates, which could prevent Jazz from entering into capacity purchase agreements with, or providing airline services to, carriers other than Air Canada, which inability could have a material adverse effect on Jazz's business, results from operations and financial condition.

#### **EXCLUSIVITY ARRANGEMENTS**

Jazz does not benefit from exclusivity arrangements preventing Air Canada from allocating some or all of its regional capacity requirements internally or to another carrier under a capacity purchase agreement, any such action by Air Canada could have a material adverse effect on Jazz's business, results from operations and financial condition.

#### **POTENTIAL CONFLICTS WITH AIR CANADA**

Conflicts may arise between Air Canada and Jazz in a number of areas, including:

- Jazz's and Air Canada's respective rights and obligations under the CPA or other agreements between Jazz and Air Canada;
- the nature and quality of the services Air Canada provides to Jazz and the services Jazz provides to Air Canada;
- the terms of Air Canada's and Jazz's respective collective bargaining agreements;
- amendments to any of the existing agreements between Jazz and Air Canada, including the CPA; and
- reductions in the number of Covered Aircraft in accordance with the CPA.

Jazz may not be able to resolve any potential conflicts with Air Canada and, even if any such conflicts are resolved, the resolution may be on terms and conditions less favourable to Jazz and Jazz's business, results from operations and financial condition could be materially adversely affected.

#### **LIMITED ABILITY TO PARTICIPATE IN IMPROVED MARKET CONDITIONS**

While the capacity purchase business model and target margin reflected in the CPA reduce Jazz's financial risk and exposure to fluctuations for many of its potentially volatile costs, they also limit Jazz's potential to experience higher earnings growth from improved market conditions.

#### **STAR ALLIANCE**

The strategic and commercial arrangements with Star Alliance™ members provide Air Canada with important benefits, including code-sharing, efficient connections and transfers, reciprocal participation in frequent flyer programs and use of airport lounges from the other members. The departure of a key member from the Star Alliance™, or any such member's ability to meet its obligations thereunder, could result in a negative impact on the network of Air Canada and Jazz and a material adverse effect on Jazz's business, results from operations and financial condition.

## Risks Relating to Jazz

### BILL C-310

On November 24, 2009, Bill C-310, An Act to Provide Certain Rights to Air Passengers, was reported back from the Standing Committee on Transport, Infrastructure and Communities. The Committee recommended that Bill C-310 not proceed any further. The Bill provides obligations on air carriers in the event of certain flight delays, flight cancellations, denied boarding to passengers or ground delays of aircraft with passengers on board. If enacted in its current form, Bill C-310 could lead to significant costs for air carriers, including Jazz, which could have a material adverse effect on Jazz's business, results from operations and financial condition. Despite the Committee's recommendations, management cannot predict whether such proposed legislation will be enacted, if at all, or if enacted whether its provisions will be in the form currently proposed by Bill C-310 or otherwise.

### EMPLOYEES

Jazz's business is labour-intensive and requires a large number of pilots, flight attendants, mechanics and other personnel. Jazz's business plan will require Jazz to locate, hire, train and retain new employees. There can be no assurance that Jazz will be able to locate, hire, train and retain a sufficient number of qualified employees that it needs to carry out its plans or replace departing employees. If Jazz is unable to hire and retain a sufficient number of qualified employees at a reasonable cost, this could have a material adverse effect on its business, results from operations and financial condition.

### LABOUR COSTS AND LABOUR RELATIONS

Labour costs constitute the largest percentage of Jazz's total operating costs that are borne by Jazz. There can be no assurance that the estimates of Jazz's future labour costs will be accurate. If such costs exceed Jazz's estimates, Jazz may realize decreased profits or even losses under the CPA.

Most of Jazz's employees are unionized and its collective bargaining agreements all expired at the end of June 2009. Jazz has pursued negotiations with each union.

On August 30, 2009, Jazz reached a tentative three year agreement with its maintenance and engineering employees who are represented by the CAW. That tentative agreement was subsequently ratified on September 12, 2009 by a union vote. On December 3, 2009, Jazz reached a tentative three year agreement with its Customer Services and Aircraft Services divisions, also represented by the CAW. That tentative agreement was subsequently ratified on December 16, 2009 by a union vote. Jazz is currently in negotiations with all other unionized groups of employees.

There can be no assurance that the collective agreements will be renewed without labour conflict or action, or that there will not otherwise be a labour conflict or action that could lead to an interruption or stoppage in Jazz's service or otherwise adversely affect Jazz's ability to conduct its operations, all of which could have a material adverse effect on its business, results from operations and financial condition. There can be no assurance that these agreements with employees' unions will be on terms in line with Jazz's expectations or comparable to agreements entered into by other regional airlines,

and any future agreements may increase labour costs or otherwise adversely affect Jazz.

A labour disruption or work stoppage by any of the unionized work groups of Air Canada could also have a material adverse effect on Jazz's business, results from operations and financial condition.

### CONDITION TO LABOUR PRODUCTIVITY ENHANCEMENTS

During the restructuring of Jazz's predecessor under the CCAA, one of the improvements made in the collective agreement with ALPA, representing Jazz's pilot group, was the implementation of productivity enhancements which require a minimum threshold of aircraft to be maintained in the fleet in order for the productivity enhancements to be available to Jazz. The productivity enhancements primarily relate to the work and scheduling provisions of the collective agreement which enables Jazz to schedule pilots for more hours in a given month at their normal hourly rate of pay. Failure by Jazz to maintain a minimum fleet of 125 aircraft after December 31, 2006 would result in a loss of the productivity enhancements, which could have a material adverse effect on Jazz's business, results from operations and financial condition.

### LEVERAGE AND RESTRICTIVE COVENANTS IN CURRENT AND FUTURE INDEBTEDNESS

The ability of Jazz to make distributions or make other payments or advances will be subject to applicable laws and contractual restrictions contained in the instruments governing any indebtedness of Jazz (including the Credit Facilities). The degree to which Jazz is leveraged could have important consequences to unitholders, including: (i) that Jazz's ability to obtain additional financing in the future for working capital, capital expenditures or acquisitions may be limited; (ii) that a significant portion of Jazz's cash flow from operations may be dedicated to the payment of the principal of and interest on its indebtedness, thereby reducing funds available for future distributions and causing taxable income for unitholders to exceed cash distributions; (iii) that certain of Jazz's borrowings will be at variable rates of interest, which exposes Jazz to the risk of increased interest rates; and (iv) that Jazz may be more vulnerable to economic downturns and be limited in its ability to withstand competitive pressures. These factors may increase the sensitivity of distributable cash to interest rate variations.

In addition, the Credit Facilities contain numerous restrictive covenants limiting the discretion of management with respect to certain business matters. These covenants place significant restrictions on, among other things, the ability of Jazz to create liens or other encumbrances, to pay distributions on the LP Units of Jazz LP or make certain other payments, investments, loans and guarantees and to sell or otherwise dispose of assets and merge or consolidate with another entity. In addition, the Credit Facilities contain a number of financial covenants that require Jazz to meet certain financial ratios and financial condition tests. A failure to comply with the obligations in the Credit Facilities could result in a default which, if not cured or waived, could result in a termination of distributions by Jazz and permit acceleration of the relevant indebtedness. If the indebtedness under the Credit Facilities, including any possible hedge contracts with the lenders, were to be accelerated, there can be no assurance that the assets of Jazz would be sufficient to repay in full that

indebtedness. Jazz will have to refinance its available Credit Facilities or other debt and there can be no assurance that Jazz will be able to do so or be able to do so on terms as favourable as those presently in place. If Jazz is unable to refinance these Credit Facilities or other debt, or is only able to refinance these Credit Facilities or other debt on less favourable and/or more restrictive terms, this may have a material adverse effect on Jazz's financial position, which may result in a reduction or suspension of cash distributions to unitholders and cause taxable income for unitholders to exceed cash distributions. In addition, the terms of any new credit facility or debt may be less favourable or more restrictive than the terms of the existing Credit Facilities or other debt, which may indirectly limit or negatively impact the ability of Jazz to pay cash distributions and cause taxable income for unitholders to exceed cash distributions.

Current global financial conditions have been characterized by increased volatility and several financial institutions have either gone into bankruptcy or have had to be rescued by governmental authorities. Access to new public financing (if required by Jazz) has been negatively impacted by these events, which may impact the ability of Jazz to obtain financing in the future on acceptable terms.

#### **RELIANCE ON KEY PERSONNEL**

The success of Jazz depends on the abilities, experience, industry knowledge and personal efforts of senior management and other key employees, and Jazz's ability to retain and attract skilled employees. The loss of the services of such key personnel could have a material adverse effect on the business, results from operations, financial condition or future prospects of Jazz. Jazz's growth plans may put additional strain and demand on management and on Jazz's employees and produce risks in both productivity and retention levels. In addition, Jazz may not be able to attract and retain additional qualified management as needed in the future.

#### **RISKS RELATING TO FINANCIAL INSTRUMENTS**

For a description of the interest rate risk, credit risk, liquidity risk and currency risk associated with Jazz's financial instruments, see the discussion in Section 9 – Financial Instruments and Risk Management.

#### **Risks Relating to the Industry**

##### **ECONOMIC AND GEOPOLITICAL CONDITIONS**

Airline operating results are sensitive to economic and geopolitical conditions, which have a significant impact on the demand for air transportation. Airline fares and passenger demand have fluctuated significantly in the past and may fluctuate significantly in the future. Air Canada is not able to predict with certainty market conditions and the fares it may be able to charge. Customer expectations can change rapidly and the demand for lower fares may limit revenue opportunities. Travel, especially leisure travel, is a discretionary consumer expense. A downturn in economic growth in North America, as well as geopolitical instability in various areas of the world, could have the effect of reducing demand for air travel. In addition, the recent increases, and any further increases, in the value of the Canadian dollar relative to the United States dollar could affect the desirability of transborder travel to Canada. Any such event could have a material adverse effect on Jazz's business, results from operations and financial condition.

In addition, fuel costs represent a major expense to air carriers. Since 2005, fuel prices have increased to and have fluctuated at near historically high levels. Should fuel prices remain at such levels or further increase, demand for air travel may decrease as a result of fuel surcharges added to airline fares and Air Canada may be unable to pass on any further increases to its customers through fuel surcharges. Though, under the terms of the CPA Jazz's fuel costs are reimbursed by Air Canada and any resulting reduction in passenger revenues is principally at Air Canada's risk, this could have a material adverse effect on Jazz's business, results from operations and financial condition if Air Canada were to reduce its capacity usage or were unable to meet its obligations under the CPA.

##### **IMPACT OF COMPETITION ON AIR CANADA'S NEED TO UTILIZE JAZZ'S SERVICES**

The airline industry is highly competitive. Air Canada competes with other major carriers as well as low cost carriers on its routes, including routes that Jazz flies under the CPA. Competitors could rapidly enter markets Jazz serves for Air Canada, and quickly discount fares, which could lessen the economic benefit of Jazz's regional operations to Air Canada.

In addition to traditional competition among airlines, the industry faces competition from ground transportation alternatives. Video teleconferencing and other methods of electronic communication have also added a new dimension of competition to the industry as businesses travelers seek substitutes to air travel.

##### **IMPACT OF INCREASED COMPETITION IN THE REGIONAL AIRLINE INDUSTRY ON JAZZ'S GROWTH OPPORTUNITIES**

Aside from the limitations under the CPA and the regulatory prohibition on cabotage, Jazz's ability to provide regional air service to a major United States airline is limited by existing relationships that all United States network airlines have with other regional operators. In addition, many of the network airlines are subject to scope clause restrictions under their collective bargaining agreements with employees that restrict their ability to add new regional jet capacity.

In addition, new competitors may enter the regional airline industry. Such new or existing competitors may enter into capacity purchase agreements with airlines, including Air Canada, in respect of routes currently operated by Jazz. Capacity growth by other regional airlines in the regional jet market would lead to significantly greater competition and may result in lower rates of return in the regional airline industry. Further, many of the network airlines are focused on reducing costs, which may also result in lower operating margins in the regional airline industry.

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

The airline industry generally, and scheduled service in particular, are characterized by low gross profit margins and high fixed costs. The costs of operating any particular flight do not vary significantly with the number of passengers carried and, therefore, a relatively small change in the number of passengers or in fare pricing or traffic mix could have a significant effect on Air Canada's operating and financial results. This condition has been exacerbated by aggressive pricing by low-cost carriers, which has had the effect of driving down fares in



general. A minor shortfall from Air Canada's expected revenue levels could have a material adverse effect on Jazz's business, results from operations and financial condition if Air Canada were to reduce its capacity usage or were unable to meet its obligations under the CPA.

#### **TERRORIST ATTACKS**

The occurrence of a terrorist attack (whether domestic or international and whether involving Air Canada, Jazz, another carrier or no carrier at all) and increasingly restrictive security measures, such as the current restrictions on the content of carry-on baggage, could have a material adverse effect on passenger demand for air travel and on the number of passengers traveling on Air Canada's and Jazz's flights. Any such event could have a material adverse effect on Jazz's business, results from operations and financial condition if Air Canada were to reduce its capacity usage or were unable to meet its obligations under the CPA.

#### **EPIDEMIC DISEASES**

The spread of H1N1, or similar diseases could have a material adverse effect on passenger demand for air travel and the number of passengers traveling on Air Canada and Jazz flights, especially in the event travel related restrictions are imposed. Any such event could have a material adverse effect on Jazz's business, results from operations and financial condition if Air Canada were to reduce its capacity or was unable to meet its obligations under the CPA.

#### **INTERRUPTIONS OR DISRUPTIONS IN SERVICE**

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

#### **DEPENDENCE ON TECHNOLOGY**

Jazz relies in part on technology, including computer and telecommunications equipment and software to increase revenues, reduce costs, and operate its business. Proper implementation and operation of technology initiatives is fundamental to Jazz's ability to operate a profitable business. Jazz continuously invests in new technology initiatives to remain competitive, and its continued ability to invest sufficient amounts to enhance technology will affect Jazz's ability to operate successfully. An inability to invest in technological initiatives would have a material adverse effect on Jazz's business, results from operations and financial condition.

Jazz's technology systems may be vulnerable to a variety of sources of failure, interruption or misuse, including by reason of natural disasters, terrorist attacks, telecommunications failures, computer viruses, hackers and other security issues. While Jazz maintains and continues to invest in technology security initiatives and disaster recovery plans, these measures may not be adequate or implemented properly. Any failure in technology employed by Jazz or technology employed by Air Canada to provide services to Jazz, including by reason of power, telecommunication or Internet interruptions, could materially and adversely affect Jazz's operations and could have a material adverse effect on Jazz's business, results from operations and financial condition.

#### **SEASONAL NATURE OF THE BUSINESS, OTHER FACTORS AND PRIOR PERFORMANCE**

Under the CPA, Jazz is paid fees by Air Canada on a variety of different metrics based on Jazz's estimated controllable costs in the applicable period marked-up by a specified percentage. Such mark-up equates to a specified margin on Jazz's estimated Scheduled Flights Revenue in the applicable period. However, Jazz's quarterly results could differ from those contemplated by the target margin based on a variety of factors, including the timing of capital expenditures and changes in operating expenses, such as personnel and maintenance costs, over the course of a fiscal year.

Jazz has historically experienced considerably greater demand for its services in the second and third quarters of the calendar year and significantly lower demand in the first and fourth quarters of the calendar year. This demand pattern is principally a result of the high number of leisure travelers and their preference for travel during the spring and summer months, 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's revenues under the CPCA do not fluctuate significantly with Passenger Load Factors.

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

#### **REGULATORY MATTERS**

The airline industry is subject to extensive Canadian and foreign government regulations relating to, among other things, security, safety, licensing, competition, noise levels, the environment and, in some measure, pricing. Additional laws and regulations may be proposed, and decisions rendered, from time to time which could impose additional requirements or restrictions on airline operations. The implementation of additional regulations or decisions by Transport Canada, the Canadian Transportation Agency, the Treasury Board or other domestic or foreign governmental entities may have a material adverse effect on Jazz's business, results from operations and financial condition. Jazz cannot give any assurances that new regulations or revisions to the existing legislation, or decisions, will not be adopted or rendered. The adoption of such new laws and regulations or revisions, or the rendering of such decisions, could have a material adverse effect on Jazz's business, results from operations and financial condition.

Jazz is also subject to domestic and United States laws regarding privacy of passenger and employee data. Compliance with these regulatory regimes is expected to result in additional operating costs and could have a material adverse effect on Jazz's business, results from operations and financial condition.

**ENVIRONMENT**

As a participant in the airline industry, Jazz is exposed to any future regulations concerning greenhouse gas emissions by its aircraft. Jazz would be faced with additional costs necessary to comply with any such regulations, which could have a material adverse effect on Jazz's business, results from operations and financial condition.

**THIRD PARTY WAR RISK INSURANCE**

There is a risk that the Government of Canada may not continue to provide an indemnity for third party war risk liability coverage, which it is currently providing Jazz and certain other carriers in Canada. In the event that the Government of Canada does not continue to provide such indemnity or amends such indemnity, Jazz and other industry participants would have to seek such coverage from commercial insurance providers. Alternative solutions, such as those proposed by International Civil Aviation Organization ("ICAO") and IATA have not developed as planned due to actions taken by other countries and the recent availability of supplemental insurance. ICAO and IATA are continuing their efforts in this area. However, the achievement of a global solution is not likely in the immediate or near future. The United States federal government has set up its own facility to provide war risk coverage to United States carriers, thus removing itself as a key component of any global plan.

Furthermore, the London aviation insurance market has announced its intention to introduce a new standard war and terrorism exclusion clause applicable to aircraft hull and spares, and similar exclusions to airline passenger and third party liability policies. Such clauses would exclude claims caused by the hostile use of a dirty bomb, electromagnetic pulse device, or bio chemical materials.

The Government of Canada indemnity program is designed to address these types of issues as they arise, but the Government of Canada has not yet decided to extend the existing indemnity to cover this exclusion. Unless and until the Government of Canada does so, the loss of coverage exposes Jazz to this new uninsured risk and may result in Jazz being in breach of certain regulatory requirements or contractual arrangements, which may have a material adverse effect on Jazz's business, results from operations and financial condition.

**CASUALTY LOSSES**

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

**Risks Relating to the Structure of the Fund****DEPENDENCE ON JAZZ**

The Fund is an unincorporated open-ended trust which is entirely dependent on the operations and assets of the Partnership through the indirect ownership of 100% of the LP Units of Jazz LP. Cash distributions to unitholders are dependent on, among other things, the ability of the Trust to pay interest on the trust notes and to make cash distributions in respect of the Trust Units, which, in turn, is dependent on Jazz LP making cash distributions in respect of the LP Units. The ability of Jazz LP or the Trust to make cash distributions or other payments or advances are subject to applicable laws and regulations and contractual restrictions contained in the instruments governing any indebtedness of those entities.

**CASH DISTRIBUTIONS ARE NOT GUARANTEED AND MAY FLUCTUATE**

Although the Fund intends to distribute the interest received in respect of the trust notes and the cash distributions received in respect of the Trust Units, less expenses and amounts, if any, paid by the Fund in connection with the redemption of Units, there can be no assurance regarding the amounts of income to be generated by the Partnership's business or ultimately distributed to the Partnership. The actual amount distributed in respect of the Units is not guaranteed and depends upon numerous factors, including the Partnership's profitability and its ability to sustain operating cash flows and the fluctuations in the Partnership's working capital and capital expenditures and refinancing of debt obligations, all of which are susceptible to a number of risks. (Refer to Section 6 – Performance Indicators for further discussion.)

If the Fund elects to convert from its current structure to a corporate structure, there can be no assurance that the Fund will maintain its current distribution policy and that dividends will be paid to its shareholders in amounts equivalent to the current monthly distributions paid to unitholders.

**NATURE OF UNITS**

The Units do not represent a direct investment in the business of the Partnership and should not be viewed by investors as direct securities of the Partnership. As holders of Units, unitholders do not have the statutory rights normally associated with ownership of shares of a corporation including, for example, the right to bring "oppression" or "derivative" actions. The Units represent a fractional interest in the Fund. The Fund's primary assets are Trust Units and trust notes. The price per Unit is a function of anticipated distributable income.

**MARKET PRICE OF UNITS**

The Units of the Fund are publicly traded at a price which does not necessarily reflect the underlying value of the Fund. The trading price of the Units may be affected by changes in general market conditions which may adversely affect the value of the Units and which are beyond the control of the Partnership and the Fund.

**UNITHOLDER LIABILITY**

The Fund Declaration of Trust provides that no unitholder of the Fund shall be subject to any liability whatsoever to any person in connection with a holding of Units. However, in jurisdictions outside the

Provinces of British Columbia, Ontario, Québec and Alberta, there remains a risk, which is considered by the Fund to be remote in the circumstances, that a unitholder could be held personally liable, despite such statement in the Fund Declaration of Trust, for the obligations of the Fund to the extent that claims are not satisfied out of the assets of the Fund. The affairs of the Fund are conducted to seek to minimize such risk wherever possible.

#### DILUTION OF EXISTING UNITHOLDERS AND LIMITED PARTNERSHIP UNITHOLDERS

The Fund Declaration of Trust authorizes the Fund to issue an unlimited number of Units for that consideration and on those terms and conditions as shall be established by the Trustees without the approval of any unitholders. The unitholders will have no pre-emptive rights in connection with such further issues. Jazz LP is permitted to issue additional LP Units for any consideration and on any terms and conditions.

#### INCOME TAX MATTERS

On October 31, 2006, the Minister of Finance (Canada) announced a "Tax Fairness Plan" which, in part, proposed changes to the manner in which certain flow-through entities and the distributions from such entities are taxed. Bill C-52, Budget Implementation Act, 2007, which received Royal Assent on June 22, 2007, contained the SIFT Rules, which are designed to implement these proposals. Under the SIFT Rules, the Fund, as a publicly traded income trust, is considered a SIFT and will be subject to trust level taxation as of January 1, 2011, at a rate comparable to the combined federal and provincial corporate tax rate on certain types of income. In addition, the taxable distributions received by unitholders will be treated as dividends from a taxable Canadian corporation.

On May 15, 2009, a separate Quebec tax regime relating to SIFT entities (the "Quebec SIFT Regime") was enacted. Under the Quebec SIFT Regime, a SIFT with an establishment in Quebec at any time in a taxation year will be subject to a Quebec tax at a rate generally equal to the Quebec tax rate relating to corporations. The Quebec SIFT Regime cross-references the corporate allocation formula, which is based on gross income and salary and wages, in order to determine the tax payable by a SIFT that has an establishment both in Quebec and outside Quebec in a taxation year. The SIFT Rules have been amended to provide for harmonization between those rules and the Quebec SIFT Regime.

The SIFT Rules could become effective on a date earlier than January 1, 2011, if the Fund is deemed to have undergone "undue expansion" during the period from November 1, 2006 to December 31, 2010, as described in the Normal Growth Guidelines issued by the Department of Finance (Canada) ("Finance") on December 15, 2006.

The Normal Growth Guidelines indicate that the Fund will not lose the benefit of the deferred application of the new tax regime to 2011 if the equity capital of the Fund does not grow as a result of issuances of new equity (which includes Units, debt that is convertible into Units, and potentially other substitutes for such equity) before 2011 by an amount that exceeds the greater of \$50.0 million and an objective "safe harbour" amount based on a percentage of the Fund's market capitalization as of the end of trading on

October 31, 2006 (measured in terms of the value of the Fund's issued and outstanding publicly traded Units, not including debt, options or interests that were convertible into Units, the "October 31, 2006 Market Capitalization"). The Normal Growth Guidelines provide for a "safe harbour" amount as follows:

#### *Time period safe harbour amount*

<u>Time Period</u>	<u>Safe Harbour Amount</u>
November 1, 2006 to December 31, 2007	40% of October 31, 2006 Market Capitalization
2008	20% of October 31, 2006 Market Capitalization
2009	20% of October 31, 2006 Market Capitalization
2010	20% of October 31, 2006 Market Capitalization

These "safe harbour" amounts are cumulative during the transition period. Management has determined that the Fund's October 31, 2006 Market Capitalization was approximately \$232.0 million.

On December 4, 2008, Finance announced an acceleration of the safe harbour amounts for 2009 and 2010 such that after December 4, 2008, they became immediately available. The safe harbour rules remained cumulative such that after December 4, 2008, the maximum amount that could be issued by a SIFT under the safe harbour rules is 100% of its October 31, 2006 market capitalization less the value of any units issued after October 31, 2006 (other than any issuances of units that would not be subject to the Normal Growth Guidelines).

As a result of the issuance of the \$86.3 million in convertible unsecured subordinated debentures in the fourth quarter of 2009, the Fund's normal growth capital allowed in 2010 is \$145.7 million (2009 – \$232.0 million)

On June 26, 2007, the Ministère des Finances (Québec) (the "Ministère") published Information Bulletin 2007-5 confirming that Quebec's tax legislation will be harmonized with the SIFT Rules but that a separate Quebec tax regime relating to SIFT entities will be implemented. More specifically, the Ministère announced that a SIFT with an establishment in Quebec at any time in a taxation year will be subject to a Quebec tax at a rate generally equal to the Quebec tax rate relating to corporations and that a business allocation formula based on the gross income of a SIFT and the wages and salaries it pays, similar to the one used for the purpose of determining the tax payable by a corporation that has activities in Quebec and outside Quebec, will apply to determine the tax payable to Quebec by a SIFT that has, in a taxation year, an establishment both in Quebec and outside Quebec. On February 26, 2008, Finance announced changes to the SIFT Rules that will, among other things, result in harmonization between the SIFT Rules and the separate Quebec tax regime relating to SIFT entities.

There can be no assurance that the Fund, the Trust or Jazz LP will be able to retain the benefit of the deferred application of the SIFT Rules until 2011. Loss of the benefit of the deferred application of the SIFT Rules until 2011 could have a material and adverse affect on the value of the Units.

The SIFT Rules may have an adverse impact on the Fund, the Trust, Jazz LP and the unitholders, on the value of the Units and on the ability of the Fund, the Trust and Jazz LP to undertake financings and acquisitions, and, at such time as the SIFT Rules apply, the distributable cash of the Fund may be materially reduced. The effect of the recently enacted SIFT Rules on the market for the Units is uncertain.

No assurance can be given that Canadian federal and/or provincial income tax law respecting income trusts and other flow-through entities will not be further changed in a manner which adversely affects the Fund and its unitholders.

#### **NATURE OF DISTRIBUTIONS**

The after-tax return for any Units owned by unitholders which are subject to Canadian income tax will depend, in part, on the composition for tax purposes of distributions paid by the Fund (portions of which may be fully or partially taxable or may be tax deferred). The composition for tax purposes of those distributions may change over time, thus affecting the after-tax return to unitholders. The SIFT Rules will apply a tax on certain income earned by a SIFT trust or partnership, and treat the taxable distributions of such income received by investors in such entities as taxable dividends. The SIFT Rules do not change the tax treatment of distributions that are in excess of the taxable income of a SIFT trust. The SIFT Rules generally do not apply to income trusts, the units of which were publicly traded as of October 31, 2006, such as the Fund, until January 1, 2011, subject to compliance with the Normal Growth Guidelines released by the Department of Finance on December 15, 2006, as may be amended from time to time.

#### **INVESTMENT ELIGIBILITY**

There can be no assurance that the Units will continue to be qualified investments for Plans under the Income Tax Act. The Income Tax Act imposes penalties for the acquisition or holding of non-qualified or ineligible investments by Plans.

#### **RESTRICTIONS ON POTENTIAL GROWTH**

The payout by the Fund of substantially all of its operating cash flow will make additional capital and operating expenditures dependent on increased cash flow or additional financing in the future. Lack of those funds could limit the future growth of the Fund and its cash flow.

#### **CONVERSION TO CORPORATE STRUCTURE**

Finance has amended the Income Tax Act (Canada) to facilitate tax deferred conversions of SIFTS to corporations. The Fund is in the process of considering its options with respect to converting to a corporate structure. Should the Fund decide to convert from its current structure to a corporate structure prior to January 1, 2011, there may be an adverse impact on the market price of the Units resulting from the change in status.

#### **RESTRICTIONS ON CERTAIN UNITHOLDERS AND LIQUIDITY OF UNITS**

The Fund Declaration of Trust imposes various restrictions on unitholders. Non-resident unitholders are prohibited from beneficially owning more than 49.9% of the Units. In addition, the voting rights of non-resident unitholders are limited to 25% of the aggregate number of outstanding votes attaching to all outstanding Units and 25% of the aggregate number of votes that may be cast at any meeting of the unitholders. These restrictions may limit (or inhibit the exercise of) the rights of certain unitholders, including non-residents of Canada and United States persons, to acquire Units, to exercise their rights as unitholders and to initiate and complete take-over bids in respect of the Units. As a result, these restrictions may limit the demand for Units from certain investors and thereby adversely affect the liquidity and market value of the Units held by the public.

The Canada Transportation Act (the "CTA") requires that a specified percentage of the voting interest of Units be owned and controlled by Canadians, as that term is defined in the CTA. In order to ensure compliance with these Canadian ownership requirements, the Fund's Declaration of Trust includes certain constraints on the voting rights of non-Canadian unitholders. Each Unit entitles the unitholder thereof to one vote, however each Unit that is not owned and controlled by a Canadian entitles the unitholder thereof to one vote, except in the following circumstances: (i) if more than 25% (or any higher percentage that the Governor in Council may by regulation specify) of the aggregate number of outstanding Units (determined on a fully diluted basis) are not owned and controlled by Canadians, the vote attaching to each Unit that is not owned and controlled by a Canadian will decrease automatically by such amount as is necessary to ensure that the aggregate number of votes attaching to all outstanding Units that are not owned and controlled by Canadians does not exceed 25% (or any higher percentage that the Governor in Council may by regulation specify) of the aggregate number of outstanding votes attaching to all outstanding Units; and (ii) if the aggregate number of votes that could be cast at any meeting in respect of Units that are not owned and controlled by Canadians would exceed 25% (or any higher percentage that the Governor in Council may by regulation specify) of the aggregate number of votes that could be cast at such meeting, the vote attaching to each Unit that is not owned and controlled by a Canadian will decrease automatically by such amount as is necessary to ensure that the aggregate number of votes that may be cast at such meeting in respect of all outstanding Units that are not owned and controlled by Canadians does not exceed 25% (or any higher percentage that the Governor in Council may by regulation specify) of the aggregate number of votes that can be cast at such meeting by all unitholders.

On February 6, 2009, the Government of Canada introduced Bill C-10 (Budget Implementation Act, 2009) ("Bill C-10"), which proposed amendments to the CTA relating to the foreign ownership restrictions on domestic air carriers. Bill C-10 received Royal Assent on March 12, 2009. The Governor in Council now has the authority on the recommendation of the Minister of Transport to fix by order, a day on which the Governor in Council may by regulation, set new foreign ownership limits up to a maximum of 49% foreign ownership. The regulations may specify that the new limits apply in the

case of all non-Canadian investors or, alternatively, a specific class of non-Canadians identified in the regulations. On October 8, 2009, the Canadian Transportation Agency announced its plans to consult with relevant stakeholders and published details of proposed regulations. The comment period expired on December 22, 2009.

No assurance can be given that Bill C-10 will be ratified into law.

### **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 counter-claimed 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 \$850,000,000 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 against Jazz and Air Canada was stayed pending the outcome of the proceeding in Federal Court. Jazz is continuing its proceeding in the Federal Court of Canada against the TPA, in which the Porter Defendants intervened and have been made parties. Jazz maintains that Porter's counterclaims in both jurisdictions are without merit. The counterclaims are currently being vigorously contested by Jazz in court. If Jazz is not successful in the Federal Court of Canada action, it will not have fair and equal access to the TCCA. If Jazz is not successful in defending the counter-claims, it could be subject to a material damages award.

### **Risks Relating to the Convertible Debentures**

#### **MATTERS AFFECTING TRADING PRICES FOR THE CONVERTIBLE DEBENTURES**

The TSX approved the listing of the Convertible Debentures and the Units issuable upon conversion, redemption or repayment thereof. There is currently no market through which the securities may be sold and purchasers may not be able to resell securities purchased under the short form prospectus. This may affect the pricing of the securities in the secondary market, the transparency and availability of trading prices, the liquidity of securities, and the extent of issuer regulation.

No assurance can be given that an active or liquid trading market for the Convertible Debentures will develop or be sustained. If an active or liquid market for the Convertible Debentures fails to develop or be sustained, the prices at which the Convertible Debentures trade may be adversely affected. Whether or not the Convertible Debentures will trade at lower prices depends on many factors, including

the liquidity of the Convertible Debentures, prevailing interest rates and the markets for similar securities, the market price of the Units, general economic conditions and Jazz's financial condition, historic financial performance and future prospects. Further, the holders of Units may suffer dilution if Jazz decides to redeem outstanding Convertible Debentures for Units or to repay outstanding principal amounts thereunder at maturity of the Convertible Debentures by issuing additional Units.

#### **CREDIT RISK AND PRIOR RANKING INDEBTEDNESS; ABSENCE OF COVENANT PROTECTION**

The likelihood that purchasers of the Convertible Debentures will receive payments owing to them under the terms of the Convertible Debentures will depend on the financial health of Jazz and its creditworthiness. In addition, the Convertible Debentures are unsecured obligations of Jazz and are subordinate in right of payment to all Jazz's existing and future senior indebtedness. Therefore, if Jazz becomes bankrupt, liquidates its assets, reorganizes or enters into certain other transactions, Jazz's assets will be available to pay its obligations with respect to the Convertible Debentures only after it has paid all of its senior and secured indebtedness in full. There may be insufficient assets remaining following such payments to pay amounts due on any or all of the Convertible Debentures then outstanding. The Convertible Debentures are also effectively and structurally subordinate to claims of creditors (including trade creditors) of Jazz's subsidiaries except to the extent Jazz is a creditor of such subsidiaries ranking at least *pari passu* with such other creditors.

#### **CONVERSION FOLLOWING CERTAIN TRANSACTIONS**

In the case of certain transactions, each Convertible Debenture will become convertible into the securities, cash or property receivable by a holder of Units in the kind and amount of securities, cash or property into which the Convertible Debenture was convertible immediately prior to the transaction. This change could substantially lessen or eliminate the value of the conversion privilege associated with the Convertible Debentures in the future. For example, if Jazz were acquired in a cash merger, each Convertible Debenture would become convertible solely into cash and would no longer be convertible into securities whose value would vary depending on Jazz's future prospects and other factors.

## 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;

**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;

**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;

**Controllable Actual Margin** – Controllable Actual Margin means for any period, the actual Controllable Operating Income divided by the actual Scheduled Flights Revenue;

**Controllable Adjusted Actual Margin** – Controllable Adjusted Actual Margin means for any period, the Controllable Actual Margin less 50% of any margin exceeding 11.11%, effective August 1, 2009 (14.32% for January 1, 2009 to July 31, 2009 and 14.09% for 2006 to 2008), at this level;

**Controllable Cost per Available Seat Mile (Controllable CASM)** – Controllable Cost per Available Seat Mile means Controllable Costs divided by Available Seat Mile;

**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;

**Controllable Operating Income** – Controllable Operating Income means for any period, Scheduled Flights Revenue less Controllable Costs;

**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 \$150.0 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;

**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;

**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 and other operating expenses incurred by Jazz;

**Passenger Load Factor** – Passenger Load Factor means a measure of passenger capacity utilization derived by expressing Revenue Passenger Miles as a percentage of Available Seat Miles;

**Productive capacity management strategy** – represents capital expenditures required to sustain operations. Capital expenditures are made in support of ongoing fleet requirements, such as aircraft communication systems, cockpit standardization, regulatory compliance, maintenance information systems infrastructure, aircraft rotatable parts and leasehold improvements.

**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;

**Revenue Passenger Miles (RPMs)** – Revenue Passenger Miles mean the total number of revenue passengers carried, including frequent flyer redemptions, multiplied by the number of miles flown by such passengers;

**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;

**Scheduled Flights Revenue** – Scheduled Flights Revenue means, for any period, all revenues generated by Jazz under the CPA from aircraft services and Scheduled Flights excluding revenues resulting from the reimbursement by Air Canada of Jazz's pass-through costs and from the payment by Air Canada of performance incentives;

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

**Trust** – Trust means Jazz Air Trust; and

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

# Consolidated Financial Statements

## AUDITORS' REPORT

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February 9, 2010

### To the Unitholders of Jazz Air Income Fund

We have audited the consolidated balance sheets of Jazz Air Income Fund as at December 31, 2009 and 2008 and the consolidated statements of unitholders' equity, income (loss), comprehensive income (loss) and cash flows for the years ended December 31, 2009 and 2008. These consolidated financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years ended December 31, 2009 and 2008 in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

Chartered Accountants  
Halifax, Nova Scotia

## MANAGEMENT'S REPORT

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February 9, 2010

The accompanying consolidated financial statements of Jazz Air Income Fund are the responsibility of management and have been approved by the Board of Trustees. The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include some amounts and assumptions based on management's best estimates which have been derived with careful judgement.

In fulfilling its responsibilities, management has developed and maintains a system of internal accounting controls. These controls are designed to provide reasonable assurance that the financial records are reliable for preparation of the financial statements. The Audit, Finance and Risk Committee of the Board of Trustees reviewed and approved Jazz's consolidated financial statements, and recommended their approval by the Board of Trustees.

*Joseph D. Randell*

Joseph D. Randell  
President and Chief Executive Officer

*A. D. Rowe*

Allan D. Rowe  
Chief Financial Officer

**CONSOLIDATED BALANCE SHEETS**

As at December 31, 2009 and 2008

(expressed in thousands of Canadian dollars)	2009 \$	2008 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	223,559	131,876
Accounts receivable – trade and other (note 15)	59,044	71,618
Spare parts, materials and supplies	40,755	46,150
Prepaid expenses	19,909	12,905
<b>Total current assets</b>	<b>343,267</b>	<b>262,549</b>
<b>Property and equipment</b> (note 3)	<b>202,994</b>	<b>219,028</b>
<b>Intangible assets</b> (note 4)	<b>682,479</b>	<b>722,102</b>
<b>Other assets</b> (note 6)	<b>37,731</b>	<b>29,468</b>
	<b>1,266,471</b>	<b>1,233,147</b>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities (note 15)	179,216	197,046
Distributions payable	6,143	10,296
Current portion of obligations under capital leases (note 7)	2,681	2,837
Current portion of long-term debt (note 8)	114,706	–
<b>Total current liabilities</b>	<b>302,746</b>	<b>210,179</b>
<b>Obligations under capital leases</b> (note 7)	<b>15,097</b>	<b>20,581</b>
<b>Long-term debt</b> (note 8)	<b>–</b>	<b>114,729</b>
<b>Convertible debentures</b> (note 9)	<b>78,180</b>	<b>–</b>
<b>Future income tax</b> (note 10)	<b>13,294</b>	<b>23,561</b>
<b>Other long-term liabilities</b> (note 11)	<b>52,699</b>	<b>56,068</b>
	<b>462,016</b>	<b>425,118</b>
<b>Unitholders' Equity</b>	<b>804,455</b>	<b>808,029</b>
	<b>1,266,471</b>	<b>1,233,147</b>

**Economic dependence** (note 15)

**Commitments** (note 16)

**Contingencies** (note 22)

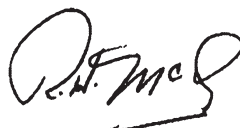
**Subsequent event** (note 23)

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

Approved by the Trustees by:



Katherine M. Lee  
Trustee



Richard H. McCoy  
Trustee



**CONSOLIDATED STATEMENTS OF UNITHOLDERS' EQUITY**

For the years ended December 31, 2009 and 2008

	Unitholders' capital	Retained earnings (deficit)		Contributed surplus	Accumulated other comprehensive income (loss)	Equity component of convertible debentures	Total
		Accumulated earnings	Distributions				
(expressed in thousands of Canadian dollars)	\$	\$	\$	\$	\$	\$	\$
<b>Balance – December 31, 2007</b>	1,034,656	29,512	(127,186)	5,952	(158)	–	942,776
Change in fair value during the year	–	–	–	–	(3,028)	–	(3,028)
Distributions	–	–	(123,552)	–	–	–	(123,552)
Units held by unit based							
compensation plans (note 18)	(205)	–	–	(1,626)	–	–	(1,831)
Accretion related to the initial							
long-term incentive plan (note 18)	–	–	–	1,850	–	–	1,850
Accretion related to the ongoing							
long-term incentive plan (note 18)	–	–	–	1,224	–	–	1,224
Net loss for the year	–	(9,410)	–	–	–	–	(9,410)
<b>Balance – December 31, 2008</b>	1,034,451	20,102	(250,738)	7,400	(3,186)	–	808,029
Change in fair value during the year	–	–	–	–	2,384	–	2,384
Distributions	–	–	(102,787)	–	–	–	(102,787)
Issue of convertible debentures (note 9)	–	–	–	–	–	4,324	4,324
Units held by unit based							
compensation plans (note 18)	829	–	–	(2,879)	–	–	(2,050)
Accretion related to the ongoing							
long-term incentive plan (note 18)	–	–	–	1,917	–	–	1,917
Net income for the year	–	92,638	–	–	–	–	92,638
Balance – December 31, 2009	1,035,280	112,740	(353,525)	6,438	(802)	4,324	804,455

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

**CONSOLIDATED STATEMENTS OF INCOME (LOSS)**

For the years ended December 31, 2009 and 2008

(expressed in thousands of Canadian dollars, except Units and earnings per Unit)	2009 \$	2008 \$
<b>Operating revenue</b> (note 15)		
Passenger	1,463,623	1,622,850
Other	10,277	13,439
	<b>1,473,900</b>	<b>1,636,289</b>
<b>Operating expenses</b> (note 15)		
Salaries and wages	293,958	292,647
Benefits	50,547	52,563
Aircraft fuel	255,842	430,216
Depreciation and amortization of property and equipment and other	30,689	30,409
Amortization of Capacity Purchase Agreement ("CPA") intangible asset	39,623	42,100
Food, beverage and supplies	13,097	14,795
Aircraft maintenance materials, supplies and services	163,677	129,533
Airport and navigation fees	192,039	199,419
Aircraft rent	135,680	127,758
Terminal handling services	101,984	107,345
Other	107,990	103,333
	<b>1,385,126</b>	<b>1,530,118</b>
<b>Operating income</b>	<b>88,774</b>	<b>106,171</b>
<b>Non-operating income (expenses)</b>		
Interest revenue	760	4,236
Interest expense	(8,607)	(8,505)
Gain on disposal of property and equipment	1,936	182
Foreign exchange loss	(1,142)	(6,263)
Goodwill impairment loss (note 5)	-	(153,230)
Unrealized gain (loss) on asset backed commercial paper ("ABCP") (note 21)	650	(2,985)
	<b>(6,403)</b>	<b>(166,565)</b>
<b>Income (loss) before future income taxes</b>	<b>82,371</b>	<b>(60,394)</b>
<b>Recovery of future income taxes</b> (note 10)	<b>10,267</b>	<b>50,984</b>
<b>Net income (loss) for the years</b>	<b>92,638</b>	<b>(9,410)</b>
<b>Earnings (loss) per Unit, basic</b> (note 13)	<b>\$ 0.76</b>	<b>\$ (0.08)</b>
<b>Earnings (loss) per Unit, diluted</b> (note 13)	<b>\$ 0.75</b>	<b>\$ (0.08)</b>

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

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

For the years ended December 31, 2009 and 2008

	2009	2008
(expressed in thousands of Canadian dollars)	\$	\$
<b>Net income (loss) for the years</b>	<b>92,638</b>	(9,410)
<b>Other comprehensive income (loss)</b>		
Change in fair value of derivatives designated as cash flow hedges	(293)	(2,408)
Reclassification of net realized gains on derivatives designated as cash flow hedges to income	2,677	(620)
<b>Comprehensive income (loss)</b>	<b>95,022</b>	(12,438)

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31, 2009 and 2008

	2009	2008
(expressed in thousands of Canadian dollars)	\$	\$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net income (loss) for the years	92,638	(9,410)
Charges (credits) to operations not involving cash		
Depreciation and amortization of property and equipment and other	30,689	30,409
Amortization of CPA intangible asset (note 2)	39,623	42,100
Amortization of prepaid aircraft rent and related fees	1,929	1,928
Gain on disposal of property and equipment	(1,936)	(182)
Unit based compensation	1,917	3,074
Foreign exchange (gain) loss	(2,843)	4,090
Future income taxes	(10,267)	(50,984)
Accretion of debt component of convertible debentures	239	-
Goodwill impairment loss	-	153,230
Unrealized (gain) loss on asset backed commercial paper	(650)	2,985
Other	(302)	(1,383)
Funding of unit based compensation plan, net of forfeitures	(2,050)	(1,831)
	<b>148,987</b>	<b>174,026</b>
Net changes in non-cash working capital balances related to operations (note 14)	<b>(18,898)</b>	<b>(18,938)</b>
	<b>130,089</b>	<b>155,088</b>
<b>Financing activities</b>		
Repayment of obligations under capital leases (note 7)	(2,669)	(2,265)
Convertible debentures, net of issue costs	82,265	-
Distributions	(106,940)	(123,552)
	<b>(27,344)</b>	<b>(125,817)</b>
<b>Investing activities</b>		
Additions to property and equipment	(13,417)	(20,661)
Decrease in long-term receivables	419	210
Proceeds on disposal of property and equipment	1,936	182
	<b>(11,062)</b>	<b>(20,269)</b>
<b>Net change in cash and cash equivalents during the years</b>	<b>91,683</b>	<b>9,002</b>
<b>Cash and cash equivalents – Beginning of years</b>	<b>131,876</b>	<b>122,874</b>
<b>Cash and cash equivalents – End of years</b>	<b>223,559</b>	<b>131,876</b>
<b>Cash payments of interest</b>	<b>9,026</b>	<b>10,747</b>
<b>Cash receipts of interest</b>	<b>837</b>	<b>4,579</b>
<b>Cash and cash equivalents comprise:</b>		
Cash	36,273	29,042
Term deposits and fixed income securities	187,286	102,834

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2009 and 2008

(expressed in thousands of Canadian dollars, except Units and per Unit amount)

### Note 1

#### Nature of operations and economic dependence

Jazz Air Income Fund (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 and amended by an amended and restated declaration of trust dated January 24, 2006, and an amending agreement dated as of March 23, 2009 (the "Jazz 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 Jazz Air LP (the "Partnership") and its general partner Jazz Air Holding GP Inc. ("Jazz GP"), a regional airline, and such other investments as the Board of Trustees of the Fund (the "Trustees") may determine. Reference to Jazz in the following notes to the consolidated financial statements refers to, as the context may require, the Fund and its subsidiaries (Jazz Air Trust (the "Trust"), the Partnership and Jazz GP) collectively, the Fund and one or more of its subsidiaries, one or more of the Fund's subsidiaries or the Fund itself.

Jazz operates a regional airline in Canada and the United States. Jazz forms an integral part of Air Canada's domestic and transborder market presence and strategy. Jazz and Air Canada are parties to an amended and restated capacity purchase agreement, effective January 1, 2006, as amended by a letter agreement (the "Rate Amending Agreement") dated July 28, 2009 and an amending agreement (the "CPA Amending Agreement") dated September 22, 2009 (as amended, the "CPA"), pursuant to which Air Canada purchases substantially all of Jazz's fleet capacity on aircraft operated by Jazz (the "Covered Aircraft"), based on predetermined rates (the "Rates") charged by Jazz to Air Canada for operating the Covered Aircraft. Jazz is economically and commercially dependent upon Air Canada and certain of its subsidiaries, as, in addition to being the primary source of revenue, these entities currently provide significant services to Jazz. In addition, Air Canada and its subsidiaries provide a substantial portion of the aircraft financing for Jazz.

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.

### Note 2

#### Significant accounting policies

##### a) Basis of presentation

These consolidated financial statements are expressed in Canadian dollars and are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Actual results could differ from those estimates.

##### b) Principles of consolidation

These consolidated financial statements include the accounts of Jazz, and the consolidated accounts of the Partnership, the variable interest entity for which Jazz is the primary beneficiary. All inter-company and inter-entity balances and transactions are eliminated.

##### c) Variable Interest Entities

At its inception, Jazz adopted Accounting Guideline 15 ("AcG 15") – Consolidation of Variable Interest Entities ("VIE"). AcG 15 defines a VIE as an entity that either does not have sufficient equity at risk to finance its activities without subordinated financial support from other parties, or where the equity investors lack the characteristic of a controlling financial interest, or that do not absorb the expected losses or receive the expected returns of the entity. VIEs are subject to consolidation by an entity if that entity is deemed the primary beneficiary of the VIE. The primary beneficiary is the party that is either exposed to a majority of the losses from the VIE's activities or is entitled to receive a majority of the VIE's residual returns or both.

Management has reviewed its ownership, contractual and financial interests in other entities and determined that, other than the consolidation of the consolidated accounts of the Partnership and unit based compensation plans referred to in note 2(g), this guideline does not impact the financial statements of Jazz.

##### d) Cash and cash equivalents

Cash and cash equivalents consist of current operating bank accounts, term deposits and fixed income securities with an original term to maturity of 90 days or less. The weighted average interest rate on investments as at December 31, 2009 is 0.32% (2008 – 1.62%).

### e) Operating revenue

Under the CPA, Jazz is paid to provide services to Air Canada as explained in notes 1 and 15. The related fees payable by Air Canada are recognized in revenue as the capacity is provided. Incentive payments and margin adjustments as described in note 15 are recognized, respectively, as increases in and reductions of, passenger revenue based on management estimates during the year.

Other revenues include charter flights, maintenance, repair and overhaul ("MRO") operations and other sources of revenue such as third party ground handling services and flight simulator revenue, all of which are recognized when the service is provided.

The CPA with Air Canada provides for a monthly payment for an amount per aircraft designed to reimburse Jazz for certain aircraft ownership costs. In accordance with Emerging Issues Committee No. 150, Determining Whether an Arrangement Contains a Lease, Jazz has concluded that a component of its revenue under the CPA is rental income since the CPA identifies the "right of use" of a specific type and number of aircraft over a stated period of time otherwise known as the Covered Aircraft. The amount deemed to be rental income is \$175,966 for the year ended December 31, 2009 (2008 – \$168,974). This amount was recorded in passenger revenue of Jazz's consolidated statements of income.

### f) Employee future benefits

The significant policies related to employee future benefits, consistent with Section 3461, "Employee Future Benefits" of the Canadian Institute of Chartered Accountants ("CICA") Handbook relating to Jazz's defined benefit pension plan for its pilots, the supplemental executive retirement plan for Jazz executives, and the Other Employee Future Benefits are as follows:

- The cost of pensions earned by employees is actuarially determined using the projected benefit method prorated on service, market interest rates, and management's best estimate of expected plan investment performance, salary escalation and retirement ages of employees. Obligations are attributed to the period beginning on the employee's date of joining the plan and ending on the earlier of the date of termination, death or retirement.
- The cost of the Other Employee Future Benefits is actuarially determined using the projected benefit method prorated on service (where applicable), market interest rates, and management's best estimate of retirement ages of employees, health care cost inflation, salary escalation and general inflation.
- The expected return on plan assets is based on the long-term expected rate of return on plan assets and the fair value of the plan assets. It is reasonably possible that management's estimate of the long-term rate of return may change as management continues to assess future investments and strategies and as a result of changes in financial markets.
- Past service costs arising from plan amendments of the defined benefit pension plan and the supplemental executive retirement plan are amortized on a straight-line basis over the average remaining service period of employees active at the date of the amendment. This period is currently 19 years for the pension plan and 14 years for the supplemental executive retirement plan.

- Cumulative unrecognized net actuarial gains and losses of the defined benefit pension plan and the supplemental executive retirement plan in excess of 10% of the greater of the accrued benefit obligation and the market value of plan assets at the beginning of the year are amortized over the average remaining service periods of active members expected to receive benefits under the plan (currently 19 years for the pension plan and 14 years for the supplemental executive retirement plan).
- The fiscal year-end date is December 31 and the measurement date of the plan's assets and obligations is December 31. Pension obligations are attributed to the period beginning on the employee's date of joining the plan and ending on the earlier of the date of termination, death or retirement. The obligations for the Other Employee Future Benefits plans are attributed to the period beginning on the employee's date of joining the plan or disablement (whichever applicable) and ending on the earlier of retirement or end of disablement or age 65 (whichever applicable).

### g) Unit based compensation

#### INITIAL LONG-TERM INCENTIVE PLAN

Jazz has made certain commitments in connection with the granting of Units to key executives as a one-time special award to recognize their efforts in connection with the completion of the initial public offering of the Jazz Air Income Fund ("Offering") and to provide them with incentive compensation under an Initial Long-Term Incentive Plan ("Initial LTIP"). On February 9, 2007, ACE Aviation Holdings Inc. ("ACE") transferred 638,223 Units to a trust for the purpose of funding the Initial LTIP. Under the terms of the Initial LTIP, 50% of the Units granted are subject to vesting conditions based on performance and the remaining 50% are time based and vested on December 31, 2008. Vesting is conditional on the approval of the board of directors. Performance based Units vest (1/3 per year) if the distributable cash target established by the board of directors, on behalf of Jazz GP, for the year is met. The distributable cash targets were met in each of the years, including the year ended December 31, 2008 and the related units vested.

Compensation costs related to the Units contributed by ACE are charged to compensation expense over the vesting period, as vesting conditions are met and based on the estimated annual performance, with the corresponding equity contribution being accreted to contributed surplus. Distributions declared by Jazz on the Units granted ultimately accrue to the employees. Forfeited Units, to the extent they were contributed by ACE, and accumulated distributions thereon, accrue to ACE. The trust is a VIE with respect to Jazz, and as such it is consolidated with Jazz's financial statements. Units contributed by ACE are credited to contributed surplus at their aggregate value on February 9, 2007, the contribution date, with an equivalent reduction of Unit holders' (the "Unitholders") capital. Compensation expense under this plan is charged to earnings over the vesting period, with a corresponding increase to equity. At December 31, 2009, the Initial LTIP is no longer in effect.

#### **ONGOING LONG-TERM INCENTIVE PLAN**

Under the terms of the Ongoing Long-term Incentive Plan (“Ongoing LTIP”), eligible employees are entitled to yearly Unit grants determined on the basis of a percentage of their annual base salary. The Units, which are held in a trust for the benefit of the eligible employees, vest at the end of a three year period (the “Performance Cycle”), commencing January 1 of the year in respect of which they are granted, subject to achieving distributable cash targets, established by the board of directors, on behalf of Jazz GP, for the Performance Cycle. Jazz has the option to issue the Units from treasury or purchase them on the secondary market. If Jazz chooses to issue Units from treasury, the Units will be granted on a deferred basis. On the grant date, plan members will be credited with the deferred Units granted to them. Grantees are also entitled to receive additional deferred Units based on cash distributions that would have been received had the deferred Units been converted to Jazz Units at the time of issuance. Distributions declared by Jazz on any Units granted under this plan, may be invested in additional Units, which will vest concurrently and proportionately with the Units granted. Forfeited Units and accumulated distributions thereon accrue to Jazz. The trust is a VIE with respect to Jazz, and as such, it is consolidated with Jazz’s financial statements. The fair value of the Units, which approximates their cost under this plan, is charged to earnings as compensation expense over the vesting period, with a corresponding increase to equity. Jazz’s cost of the Units held is presented as a reduction of Unitholders’ capital. Estimated compensation costs relative to this plan are accrued on the basis of actual performance relative to targets.

#### **h) Financial instruments**

Financial instruments are classified as follows:

- Cash and cash equivalents are classified as “Financial Assets Held for Trading”. These financial assets are marked-to-market through net income at each period end.
- Accounts receivable are classified as “Loans and Receivables”. After their initial fair value measurement, they are measured at amortized cost using the effective interest rate method. Allowances for doubtful accounts are established by management, on an account-by-account basis, based on, among other factors, prior experience and knowledge of the specific debtor and its assessment of the current economic environment.
- Accounts payable, distributions payable, credit facilities, and convertible debentures are classified as “Other Financial Liabilities”. After their initial fair value measurement they are measured at amortized cost, net of transaction costs, using the effective interest rate method.

#### **i) Hedges**

Jazz applies hedge accounting to its interest rate swaps and treats them as cash flow hedges. These derivatives are marked-to-market at each period end and resulting gains/losses are recognized in comprehensive income to the extent the hedging relationship is effective.

#### **j) Property and equipment**

Property and equipment are depreciated to estimated residual values based on the straight-line method over their estimated service lives. Aircraft and flight equipment are depreciated over 20 to 30 years, with 5 – 20% estimated average residual values.

Buildings are depreciated over their useful lives not exceeding 40 years on a straight-line basis. An exception to this is where the useful life of the building is greater than the term of the land lease. In these circumstances, the building is depreciated over the life of the lease.

Depreciation on other property and equipment is provided on a straight-line basis from the date assets are placed in service, to their estimated residual values, over the following estimated useful lives:

<b>Leaseholds</b>	Over the term of the related lease
<b>Ground and other equipment</b>	5 years

Property under capital leases and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of fair value of the property or equipment and the present value of those lease payments. Property and equipment under capital leases are depreciated to estimated residual value over the life of the lease.

Property and equipment is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be used is measured by comparing the net book value of the asset to the undiscounted future cash flows expected to be generated by the asset. An impairment is recognized to the extent that the carrying amount exceeds the fair value of the asset.

#### **k) Transaction costs**

Transaction costs that are incremental and directly attributable to the acquisition or issue of a financial asset or financial liability are recorded as follows:

- **Held for trading** – expensed as incurred; and
- **Loans and receivables, and other liabilities** – included in the carrying value of the financial asset or financial liability and amortized over the expected life of the financial instrument using the effective interest method.

Transaction costs for operating leases are capitalized and amortized over the life of the lease on a straight-line basis.

#### **l) Intangible assets and goodwill**

Intangible assets with finite lives are carried at their cost, net of amortization; while assets with indefinite lives are not amortized and are reviewed annually for impairment.

The CPA intangible asset has a finite life, is carried at cost and amortized over the initial term of the CPA plus renewal periods.

Goodwill represents the excess of the acquisition cost of companies over the fair value of the identifiable net assets acquired and is not amortized. At December 31, 2008, Jazz determined its goodwill was fully impaired and recorded a write-down of \$153,230.

#### **m) Impairment of long-lived assets**

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

Indefinite life assets are subject to annual impairment tests under GAAP, or when events or circumstances indicate a potential impairment. Any impairment would be recognized as an expense in the period of impairment.

#### **n) Foreign currency translation**

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange in effect at the date of the balance sheet. Non-monetary assets, liabilities and other items recorded in income are translated at rates of exchange in effect at the date of the transaction. Foreign exchange losses of \$1,142 for the year ended December 31, 2009 (2008 – \$6,263) were included in other non-operating income/expense.

#### **o) Aircraft lease payments**

Total aircraft rentals under operating leases and the related lease inducements received and fees paid over the lease term are amortized to operating expense on a straight-line basis. Prepaid aircraft rentals and related fees are the difference between the straight-line aircraft rent and the payments stipulated under the lease agreements and legal and related transaction fees associated with the leases. Current and non-current unamortized lease inducements are included in accounts payable and accrued liabilities and other long-term liabilities, respectively.

#### **p) Spare parts, materials and supplies**

Spare parts, materials and supplies are valued at the lower of cost, determined on a first in, first out basis, and net realizable value. For the year ended December 31, 2009, the cost of inventories recognized as expense was \$38,206 (2008 – \$37,277). For the year ended December 31, 2009, inventory writedowns to net realizable value of \$3,359 were recognized as an expense (2008 – \$431).

#### **q) Maintenance and repairs**

Maintenance and repair costs are charged to operating expenses as incurred. Significant modification costs considered to be betterments are capitalized and amortized over the remaining service lives of the applicable assets.

Jazz uses the direct expense method of accounting for its airframe overhauls where the expense is recorded when the overhaul event occurs. Jazz has most of its aircraft engines under long-term engine service agreements that cover the scheduled and unscheduled repairs for the covered engines. Under the terms of the agreements, Jazz pays a set dollar amount per engine hour flown on a monthly basis and the third party vendor assumes the responsibility to repair the engines at no additional cost to Jazz, subject to certain specified exclusions. Maintenance costs under these contracts are recognized when a contractual obligation exists. For those engines not covered under a long-term engine service agreement, the overhaul events are expensed in the period when the event occurs. The costs of maintenance for airframe and avionics components, landing gear and normal recurring maintenance are expensed as incurred.

#### **r) Future income tax**

Jazz uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the year that includes the date of enactment or substantive enactment.

#### **s) Earnings per Unit**

Earnings per Unit are calculated on a weighted average number of units outstanding basis. Units held under the Unit based compensation plans reduce the weighted average number of outstanding Units from the date they are contributed to the plan.

Diluted earnings per Unit are calculated using the "if converted" method. Under this method, the interest charges on convertible debentures are added back to the numerator, net of tax. The convertible debentures are considered to have been issued at the beginning of the period on time of issuance and the resulting weighted average dilutive Units are included in the denominator.

#### **t) Distribution to Unitholders**

Distributions payable by Jazz to its Unitholders, which are determined at the discretion of the Trustees, are recorded when declared.

#### **Changes in accounting policies**

##### **GOODWILL AND INTANGIBLE ASSETS**

In February 2008, the Canadian Accounting Standards Board ("AcSB") issued Section 3064, "Goodwill and Intangible Assets", to replace Section 3062, "Goodwill and Other Intangible Assets". This new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets by profit-oriented enterprises. The adoption of this new section had no impact on Jazz's consolidated financial statements.



## FINANCIAL INSTRUMENTS

In June 2009, the AcSB issued amendments to Section 3862, "Financial Instruments – Disclosures", to require enhanced disclosures about the relative reliability of the data, or "inputs", that an entity uses in measuring the fair values of its financial instruments. The new requirements are effective for annual financial statements for fiscal years ending after September 30, 2009. The additional disclosures are included in note 21.

## CREDIT RISK AND FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

On January 20, 2009, the Emerging Issues Committee ("EIC") of the Canadian Accounting Standards Board issued EIC Abstract 173, "Credit Risk and Fair Value of Financial Assets and Financial Liabilities", which establishes guidance requiring an entity to consider its own credit risk as well as the credit risk of the counterparty in determining the fair value of financial assets and financial liabilities, including derivative instruments. This interpretation must be applied retrospectively without restatement of prior years. The adoption of this interpretation did not have a significant impact on Jazz's consolidated financial statements.

## Change in accounting estimate

In the fourth quarter of 2009, Jazz changed its estimate of the useful life of the CPA intangible asset to coincide with the extended term of the CPA provided under the CPA Amending Agreement. This change has been applied prospectively. The change had the effect of decreasing amortization by \$2,477 for the year ended December 31, 2009.

## Future accounting changes

### CONVERGENCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

In January 2006, the 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 Jazz will be required to prepare IFRS financial statements for the interim periods and fiscal year ends beginning in 2011. Jazz 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 consists of the following phases: raise awareness and initial assessment; detailed assessment; and implementation and review. Phase 1 was completed in the third quarter of 2008. Jazz continues to work on Phase 2 and has commenced work on Phase 3. At this time, Jazz does not believe any significant changes to the financial reporting system will be necessary to facilitate the change-over.

## 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.

## Note 3 Property and equipment

As at December 31, 2009	Cost	Accumulated	Net
	\$	amortization	\$
Flight equipment	167,114	26,347	140,767
Facilities	14,294	1,625	12,669
Equipment	27,855	13,101	14,754
Leaseholds	32,473	14,172	18,301
Assets under capital leases	23,201	6,698	16,503
	264,937	61,943	202,994

As at December 31, 2008	Cost	Accumulated	Net
	\$	amortization	\$
Flight equipment	160,204	13,504	146,700
Facilities	14,137	984	13,153
Equipment	23,893	7,206	16,687
Leaseholds	31,586	8,448	23,138
Assets under capital leases	23,201	3,851	19,350
	253,021	33,993	219,028

The net book value of the property and equipment pledged as collateral under the credit facility at December 31, 2009 was \$186,491 (2008 – \$199,678). Amortization expense related to property and equipment of \$30,526 was recorded for the year ended December 31, 2009 (2008 – \$28,926).

#### Note 4 Intangible assets

As at December 31, 2009	Cost	Accumulated amortization	Net
	\$	\$	\$
<b>Indefinite life assets</b>			
Jazz tradename	1,836	–	1,836
Operating license	4,600	–	4,600
<b>Finite life assets</b>			
CPA	783,184	107,141	676,043
	789,620	107,141	682,479
<b>As at December 31, 2008</b>			
	\$	\$	\$
<b>Indefinite life assets</b>			
Jazz tradename	1,836	–	1,836
Operating license	4,600	–	4,600
<b>Finite life assets</b>			
CPA	783,184	67,518	715,666
	789,620	67,518	722,102

During the year ended December 31, 2009, Jazz recorded amortization expense of \$39,623 (2008 – \$42,883).

#### Note 5 Goodwill

As at December 31,	2009	2008
	\$	\$
Opening balance – December 31	–	147,284
Goodwill adjustment <sup>(1)</sup>	–	5,946
Goodwill impairment loss	–	(153,230)
Closing balance – December 31	–	–

(1) During the second quarter of 2008, Jazz adjusted the purchase price allocation to reflect certain previously unrecorded long-term liabilities related to post-employment future benefits, which were assumed by the Partnership upon inception. This resulted in an increase in goodwill of \$5,946.

At December 31, 2008 Jazz performed an impairment test of goodwill to compare its carrying value to fair value. The impairment test is based on a two step process. In step one a fair value was determined using two different valuation methods, a market based approach and a Discounted Cash Flow (“DCF”) approach. The market based approach derives a fair value based on the market capitalization of Jazz. The DCF approach analyzes future cash flows based on internally developed forecasts and then discounts them based on an industry average weighted average cost of capital. Step one showed a carrying value that exceeded fair value and as a result Jazz proceeded to perform step two.

Step two required the fair value determined in step one to be allocated to each individual asset and liability (including any previously unrecognized intangible assets), as it would be in a business combination. After performing this allocation there was no remaining fair value to be allocated to goodwill and as a result, the entire \$153,230 of goodwill was deemed to be impaired. The impairment loss was recorded in non-operating expenses.

The circumstances that led to the impairment of goodwill were as a result of the challenges and uncertainties in the airline industry.

In determining fair value, management relied on a number of factors including operating results, business plans, anticipated future cash flows and marketplace data. There are inherent uncertainties related to these factors and management’s judgment in applying them to the analysis of goodwill impairment.

**Note 6**  
**Other assets**

As at December 31,	2009	2008
	\$	\$
Promissory note receivable, non-interest bearing, repayable in equal annual installments over 10 years	–	419
Prepaid aircraft rent and related fees, net of accumulated amortization	25,362	26,644
Accrued pension benefit asset (note 19)	11,316	396
Asset backed commercial paper (note 21)	1,053	2,009
	<b>37,731</b>	<b>29,468</b>

**Note 7**  
**Obligations under capital leases**

Jazz has entered into capital leases related to aircraft and ground equipment. The obligations are as follows:

	2009	2008
	\$	\$
Year ended December 31, 2009	–	4,796
2010	4,147	4,796
2011	4,119	4,764
2012	3,772	4,367
2013	3,746	4,341
2014	3,746	–
Thereafter	3,164	8,008
Total minimum lease payments	22,694	31,072
Less: Amount representing interest (at rates ranging from 8.755% to 9.450%)	4,916	7,654
Present value of net minimum capital lease payments	17,778	23,418
Less: Current portion	2,681	2,837
Obligations under capital leases	15,097	20,581

A significant portion of the lease payments is payable in US dollars. Interest of \$1,815 (2008 - \$1,895) relating to capital lease obligations has been included in aircraft rent.

## Note 8 Long-term debt

The following provides a breakdown of Jazz's authorized and outstanding credit facilities:

	Authorized \$	Drawn at December 31, 2009 \$	Drawn at December 31, 2008 \$
Revolving term facility (a)	35,000	–	–
Term facility (b)	115,000	115,000	115,000
Prepaid interest (c)	–	(294)	(213)
Unamortized commitment fee (c)	–	–	(58)
	150,000	114,706	114,729
Less: Current portion	–	114,706	–
Total	150,000	–	114,729

- (a) The revolving term facility matures on February 1, 2010 (refer to note 23) and bears interest at rates ranging from Canadian prime rate and US base rate plus 1.75% to 2.75% and the bankers' acceptance rate and LIBOR plus 2.75% to 3.75%. As at December 31, 2009, there were no borrowings under the revolving term facility. Available credit under the revolving term facility, after deducting letters of credit, bears interest at 0.50%. Interest expense on the credit facility for the year ended December 31, 2009 was \$7,415 (2008 – \$8,482).

### Letters of credit

Jazz has issued irrevocable letters of credit in the aggregate amount of \$3,241. This amount reduces the available credit under the revolving term facility and bears interest at 2.875%.

- (b) The term facility matures on February 1, 2010 (refer to note 23) and bears interest at rates ranging from Canadian prime rate and US base rate plus 1.75% to 2.75% and the bankers' acceptance rate and LIBOR plus 2.75% to 3.75%. As at December 31, 2009, of borrowings under the term facility, \$114,400 were in the form of bankers' acceptances with a 90 day term and an effective interest rate of 3.20%. A further \$600 was in the form of prime rate advances bearing interest at 4.00%. As at December 31, 2009, Jazz had entered into interest rate swap agreements with a third party in respect of \$115,000 of debt which has effectively resulted in a fixed interest rate of 5.98% until February 2, 2010.
- (c) Long-term debt is presented net of prepaid interest and unamortized financing charges.

Borrowings under the credit facilities are secured by substantially all the present and future assets of Jazz. The continued availability of the credit facilities is subject to Jazz's ability to maintain certain leverage, debt service and interest coverage covenants, as well as other affirmative and negative covenants. As at December 31, 2009, Jazz is in compliance with all debt covenants.

## Note 9 Convertible debentures

On October 22, 2009, Jazz announced that it had entered into an agreement to sell to a group of underwriters \$75,000 principal amount of 9.50% convertible unsecured subordinated debentures (the "Debentures"). This transaction closed on November 12, 2009. Jazz granted the underwriters an option, exercisable in whole or in part at any time up until 30 days after the closing date, to purchase an additional \$11,250 principal amount of Debentures, at the same price. This option was exercised on November 25, 2009. The total gross proceeds of the financing were \$86,250. The net proceeds received by Jazz from the sale of Debentures were \$82,265 after deduction of the underwriters' fee and the expenses of the offering. Proceeds from the offering will be used for working capital requirements and for general purposes of Jazz.

The Debentures 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), the earlier of the Maturity Date and the date fixed for redemption at a conversion price of \$5.25 per Unit (the "Conversion Price"). The Debentures are not redeemable on or before December 31, 2012, except on 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. The offering was made in all provinces and territories of Canada.

Upon issuance, the Debentures were separated into liability and equity components based on the respective estimated fair values at the date of issuance. The fair value of the liability component is estimated based on the present value of future interest and principal payments due under the terms of the Debentures using a discount rate for similar debt instruments without a conversion feature. The value assigned to the equity component is the estimated fair value ascribed to the holder's option to convert. Interest expense on the Debenture is determined by applying an effective interest rate to the outstanding liability component. The difference between actual cash interest accrued and interest expense is accreted to the liability component.

The following table allocates the Debentures between debt and equity:

	<b>Cost of borrowing</b>	<b>Debt \$</b>	<b>Equity \$</b>	<b>Total \$</b>
Convertible debentures	9.5%	81,717	4,533	86,250
Transaction costs <sup>(1)</sup>		(3,776)	(209)	(3,985)
At issuance		77,941	4,324	82,265
Accretion expense		239	–	239
As at December 31, 2009		78,180	4,324	82,504

(1) Transaction costs are capitalized and offset with the debt and equity portions of the debentures and amortized over the life of the debentures using the effective interest rate.

For the year ended December 31, 2009, the total interest expense was \$1,267, which comprised of accrued interest of \$1,028 and interest accretion of \$239.

## **Note 10 Future income tax**

Under the provisions of Bill C-52, Budget Implementation Act, 2007, which received Royal Assent on June 22, 2007, Jazz, as a publicly traded income trust, is considered a specified investment flow-through and will become subject to income taxes commencing January 1, 2011. Prior to 2011, Jazz continues to qualify for special income tax treatment that permits a tax deduction by Jazz for distributions paid to its Unitholders. For accounting purposes, Jazz has computed future income tax based on temporary differences at the substantively enacted tax rate expected to apply when the temporary differences are expected to reverse. For periods prior to January 1, 2011, Jazz has not recognized any current income taxes or future income tax assets or liabilities on temporary differences expected to reverse prior to 2011 as the Trust is committed to distribute to its Unitholders all or virtually all of its taxable income that would otherwise be taxable in Jazz. Based on substantively enacted tax rates in effect at December 31, 2009, Jazz is applying a tax rate of 28.4% for 2011 and 26.9% for 2012 and subsequent years.

The future income tax provision reflects the impact of the new legislation and the tax rate changes and accounts for the entire difference between the amount of the future income tax provision and the statutory income tax dollar amount of \$nil.

The tax effects of temporary differences that give rise to significant portions of the future income tax assets and future income tax liabilities at December 31, 2009, that are expected to reverse after 2010, are presented below:

<b>As at December 31,</b>	<b>2009 \$</b>	<b>2008 \$</b>
<b>Future income tax assets</b>		
Property and equipment – differences in net book value and undepricated capital cost	7,862	–
Deferred lease inducements	10,282	10,701
Other	1,068	3,529
	<b>19,212</b>	<b>14,230</b>
<b>Future income tax liabilities</b>		
Intangibles	32,506	31,856
Property and equipment – differences in net book value and undepricated capital cost	–	5,935
	<b>32,506</b>	<b>37,791</b>
Net future income tax liability	<b>13,294</b>	<b>23,561</b>
<b>Income tax (recovery) expense is comprised of:</b>		
Future income tax recovery, exclusive of the effects of other components below	(8,921)	(8,080)
Future income tax recovery resulting from impairment of goodwill	–	(42,904)
Future income tax recovery related to the change in the taxation rate	(1,346)	–
Net future income tax recovery	<b>(10,267)</b>	<b>(50,984)</b>

**Note 11**  
**Other long-term liabilities**

As at December 31,	2009	2008
	\$	\$
Accrued other future employee benefits liability (note 19)	8,062	6,991
Deferred operating lease inducements, non-current portion	44,637	49,077
	<b>52,699</b>	56,068

**Note 12**  
**Distributions**

On July 28, 2009, the Trustees adjusted cash distributions in light of the amendments to the CPA and to otherwise improve liquidity during an uncertain period. Effective with the distribution payment paid in September to Unitholders of record on August 31, 2009, the Board resolved to reduce cash distributions by approximately 40% to \$0.60 per Unit annually.

Jazz declared a distribution for the month ended December 31, 2009 of \$0.0500 per Unit (December 31, 2008 – \$0.0838 per Unit). The distribution of \$6,143 (2008 – \$10,296) is payable January 15, 2010 to Unitholders of record on December 31, 2009.

Distributions declared, to the Unitholders of record on the last business day of each month, for the period ended December 31, 2009 aggregated to approximately \$102,787 and for the same period in 2008 aggregated to approximately \$123,552, as follows:

	2009		2008	
	Amount \$	Amount per Unit \$	Amount \$	Amount per Unit \$
January	10,296	0.0838	10,296	0.0838
February	10,296	0.0838	10,296	0.0838
March	10,296	0.0838	10,296	0.0838
April	10,296	0.0838	10,296	0.0838
May	10,296	0.0838	10,296	0.0838
June	10,296	0.0838	10,296	0.0838
July	10,296	0.0838	10,296	0.0838
August	6,143	0.0500	10,296	0.0838
September	6,143	0.0500	10,296	0.0838
October	6,143	0.0500	10,296	0.0838
November	6,143	0.0500	10,296	0.0838
December	6,143	0.0500	10,296	0.0838
	<b>102,787</b>	<b>0.8366</b>	123,552	1.0056

**Note 13**  
**Units**

Jazz may issue an unlimited number of Units for the consideration of, and on the terms and conditions determined by, the Trustees. Each Unit is transferable and represents an equal undivided beneficial interest in any distribution from Jazz. All Units are of the same class and have equal rights and privileges with respect to distributions.

Units are redeemable at any time on demand by the Unitholder. The redemption price per Unit is equal to the lesser of 90.0% of the market price on the date of surrender of the Unit for redemption and 100.0% of the closing market price on the redemption date. The total amount payable in respect of Units tendered for redemption in the same calendar month shall not exceed \$50. During the year ended December 31, 2009, Jazz redeemed nil Units (54 Units redeemed for total cash consideration of less than \$1 for the year ended December 31, 2008).

### Units outstanding

The issued and outstanding Units are summarized as follows:

Description	December 31, 2009		December 31, 2008	
	Number of Units	\$	Number of Units	\$
Issued for \$10 each, net of issue costs of \$3,826	25,000,000	246,174	25,000,000	246,174
Issued on February 9, 2007 for \$8.55 each	638,223	5,457	638,223	5,457
Issued on March 14, 2007 for \$8.03 each	50,000,000	401,500	50,000,000	401,500
Issued on March 30, 2007 for \$8.21 each	47,226,920	387,733	47,226,920	387,733
Subtotal	122,865,143	1,040,864	122,865,143	1,040,864
Redemption of Units tendered	(1,131)	(8)	(1,131)	(8)
Issued and outstanding, before the following	122,864,012	1,040,856	122,864,012	1,040,856
Units held to fund unit based compensation plans (note 18)	(869,668)	(5,576)	(749,882)	(6,405)
Total issued and outstanding	121,994,344	1,035,280	122,114,130	1,034,451

### Earnings per Unit

The following table provides a breakdown of the numerator and denominator used in the calculation of earnings per Unit and diluted earnings per Unit.

<b>As at December 31,</b>	<b>2009</b>	<b>2008</b>
<b>Numerator</b>	<b>\$</b>	<b>\$</b>
Income (loss)	92,638	(9,410)
Interest expense on convertible debentures, net of tax	870	–
Diluted income	93,508	(9,410)
<b>As at December 31,</b>	<b>2009</b>	<b>2008</b>
<b>Denominator</b>	<b>\$</b>	<b>\$</b>
Weighted average number of Units	121,976,518	122,074,380
Weighted average convertible debenture dilutive Units	2,250,489	–
Weighted average number of diluted Units	124,227,007	122,074,380

## Note 14

### Statement of cash flows – supplementary information

Net changes in non-cash working capital balances related to operations:

Year ended December 31,	2009	2008
	\$	\$
Decrease (increase) in accounts receivable – trade and other	12,574	10,817
Decrease (increase) in spare parts, materials and supplies	5,395	(8,563)
Decrease (increase) in prepaid expenses	(7,004)	(4,345)
Decrease (increase) in other assets	(11,444)	(396)
Increase (decrease) in accounts payable and accrued liabilities	(15,446)	(7,732)
Increase (decrease) in other long-term liabilities	(2,973)	(8,719)
	(18,898)	(18,938)

## Note 15

### Economic dependence

The transactions between Air Canada and its subsidiary and Jazz are summarized in the table below:

Year ended December 31,	2009	2008
	\$	\$
<b>Operating revenue</b>		
Air Canada	1,462,532	1,622,589
<b>Operating expenses</b>		
Air Canada <sup>(1)</sup>	101,467	111,295
Air Canada Capital Ltd.	98,988	92,583

The following balances with Air Canada and its subsidiary are included in the financial statements:

As at December 31,	2009	2008
	\$	\$
<b>Accounts receivable</b>		
Air Canada <sup>(1)</sup>	53,335	58,522
<b>Accounts payable and accrued liabilities</b>		
Air Canada <sup>(1)</sup>	59,048	73,529
Air Canada Capital Ltd.	8,422	9,405

(1) Includes amounts related to ACGHS Limited Partnership, now a division of Air Canada.

## Capacity Purchase Agreement

Jazz is party to the CPA with Air Canada, under which Air Canada purchases the capacity of certain specified aircraft operated by Jazz under the tradename of "Air Canada Jazz" on routes specified by Air Canada. Under this agreement, Jazz is required to provide Air Canada with the capacity of the specified aircraft, all crews and applicable personnel, aircraft maintenance, and airport operations for such flights. Air Canada determines routes and controls scheduling, sets ticket prices, determines seat inventories, and performs marketing and advertising for these flights. Air Canada retains all revenue derived from the sale of seats to passengers and cargo services and pays Jazz for the capacity provided.

Jazz is paid fees, on a monthly basis, for the capacity provided. These fees consist of a number of variable components based on different metrics, including block hours flown, flight hours, cycles (number of take-offs and landings), number of passengers and number of aircraft covered by the CPA. The rates for these metrics are fixed for annual periods and vary by aircraft type with current rates in effect until December 31, 2011. 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. As these costs are required to operate the aircraft provided under the CPA, the reimbursement of these costs are included in revenue. Pass-through costs amounted to \$488,374 for the year ended December 31, 2009 (2008 – \$668,557).

The fees which are related to controllable costs are paid on the first day of each month based on estimates for that month. Such estimates are reconciled at the end of the month for actual amounts and true-up payments are made no later than the 30th day of the following month. Pass-through costs are reimbursed by Air Canada 30 days following the month in which they were incurred.

Pursuant to the terms of the CPA, Jazz and Air Canada agreed to re-set detailed rates (subject to the terms of the contract, including the controllable target margin requirements) 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 for the three-year period ending December 31, 2011. The new rates are retroactive to January 1, 2009.



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. Rates under the CPA were established so as to achieve a controllable target margin of 14.32% for Jazz, effective January 1, 2009 (for the years 2006 to 2008, the target margin was 14.09%), excluding incentive and pass-through revenue, and before the deduction of incentive compensation expense paid to employees as a result of performance achievements on the CPA services provided to Air Canada.

### **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 formally reflect certain amendments to the CPA, including the following.

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. Block Hours are calculated by adding 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 ("Block Hours"). 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.

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 and reflected in the Rate Amending Agreement were established to enable Jazz to achieve a Controllable Target Margin of 14.32%, corresponding to a Controllable Target 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 commencing August 1, 2009, an agreed set of revised Rates became effective, under which Jazz achieves a Controllable Target Margin of 11.11%, excluding incentive and pass-through revenue, and before the deduction of incentive compensation expense paid to employees as a result of performance achievements on the CPA services provided to Air Canada, corresponding to a Controllable Mark-Up of 12.50% on Jazz's Controllable Costs.

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 lost margin due to the reduction in flying. If, on the other hand, the Annual Delivered Block Hours are greater than 375,000 Block Hours, the Controllable Mark-Up of 12.50% shall 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 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 shall commence with the return of eight CRJ 200 and two CRJ 100 aircraft upon the expiry of the subleases for such aircraft. Following the return of these aircraft the fleet of Covered Aircraft shall be temporarily reduced to 123 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 five 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"). If an agreement is reached, Air Canada may commence the use of such Swing Aircraft to operate Scheduled Flights commencing in 2011, following the delivery of a third new turboprop aircraft to Jazz. 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.

### Margin adjustment

As a result of the CPA Amending Agreement, subject to the adjustments described above, the controllable target margin has been reduced from 14.32% to 11.11% effective August 1, 2009. With respect to each calendar year after 2009, during the remaining term of the CPA, if the annual margin for flights provided under the CPA is greater than 11.11%, Jazz will pay Air Canada an amount equal to 50% of the dollar value of the margin exceeding 11.11%. Margin represents the total operating revenue from scheduled flights under the CPA less expenses incurred related to such flights, including employee incentive compensation expense; however, it excludes incentive and pass-through revenue. This margin adjustment for the year ended December 31, 2009 of \$nil (2008 – \$nil) is accounted for as a reduction of revenue.

### 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.

### Note 16 Commitments

Jazz is committed to the following future minimum lease payments under operating leases for flight equipment and base facilities that have initial or remaining non-cancellable terms in excess of one year.

As at December 31, 2009	Other third parties \$	Air Canada and its subsidiaries \$
Year ending December 31, 2010	12,764	113,834
2011	9,168	94,419
2012	5,865	88,489
2013	4,863	86,600
2014	4,455	86,223
Thereafter	27,823	555,062

A significant portion of the lease payments is payable in US dollars.

Certain of the aircraft lease agreements have been entered into by Air Canada Capital Ltd. or Air Canada with head lessors and subleased to Jazz. Future minimum lease payments that will arise under these leases are listed in the above table under the heading “Air Canada and its subsidiaries”.

### Note 17 Post-employment expenses

Jazz has recorded pension and other post-employment future benefit expenses for the year ended December 31, 2009 of \$15,937 (2008 – \$18,049).

## Note 18 Unit based compensation

The details of Units held under unit based compensation plans discussed in note 2 are as follows:

	December 31, 2009		December 31, 2008	
	Initial LTIP	Ongoing LTIP	Initial LTIP	Ongoing LTIP
Number of Units granted	638,223	995,892	638,223	472,542
Number of Units forfeited	(64,201)	(126,224)	(64,201)	(59,259)
Number of Units vested	574,022 (574,022)	869,668 –	574,022 (237,423)	413,283 –
Number of Units outstanding, end of year	–	869,668	336,599	413,283
Weighted average remaining life (years)	–	1.27	nil	1.55
Cost of units purchased during the year <sup>(1)</sup>	–	\$ 2,268	\$ –	\$ 2,178
Weighted average fair value per Unit on date of grant	–	\$ 6.41	\$ 8.55	\$ 8.14
Compensation expense for the year	–	\$ 1,917	\$ 1,850	\$ 1,224

(1) The cost of Units purchased under the Ongoing LTIP is not materially different from their fair value at the date they were granted.

During the year ended 2009, Jazz granted 523,350 Units (2008 – 271,104 Units) under the Ongoing LTIP. The weighted average fair value of these Units was \$4.33 (2008 – \$8.03).

## Note 19 Pension and other future employee benefits

Jazz maintains several registered defined contributions pension plans for eligible employees and a registered defined benefit plan for Pilots, which effective May 24, 2007, are consolidated in these financial statements. Jazz is the plan sponsor for these plans under the Pension Benefits Standard Act, 1985 (Canada). In addition, Jazz maintains an unregistered supplementary defined benefit pension plan which is partially funded for certain employees. Contributions to the supplementary pension plan started being made in December 2007. The registered and supplementary defined benefit pension plans provide benefits upon retirement, termination or death based on the member's years of service and the final average earnings for a specified period.

Jazz also maintains Other (non-pension) Employee Future Benefits. The Other Employee Future Benefits include medical and dental benefits provided to the employees on long-term disability and Workplace Safety Insurance Board ("WSIB"). These benefits cease to be provided when the employee reaches age 65. The sick leave gratuity

benefits represent the payout of sick leave accruals upon or just prior to retirement for eligible employees. The self-insured WSIB benefits are in respect of self-insured benefits provided to Ontario employees.

The total expense for Jazz's defined contribution plans including two pension plans sponsored by an employee group and a union respectively, for which Jazz is obligated to make defined contributions only, for the year ended December 31, 2009 is \$7,301, and for the year ended December 31, 2008 is \$7,097.

Total cash payments made by Jazz in 2009 for registered pension plans were \$21,408, which includes cash payments for the Registered Defined Benefit Plan of \$14,486 (year December 31, 2008 – \$18,797; \$11,962 for the Registered Defined Benefit Plan). Total cash payments made in 2009 for the Other Employee Future Benefits were \$1,204.

The most recent actuarial valuations of the defined pension benefit plans for funding purposes were as of January 1, 2009 and the next funding valuation will be as of January 1, 2010.

Information about Jazz's defined benefit plans and other future employee benefits in aggregate, is as follows:

	Pension Benefits		Other Future Employee Benefits	
	2009 \$	2008 \$	2009 \$	2008 \$
<b>Change in benefit obligation</b>				
Benefit obligation, beginning of year	99,005	105,308	7,986	5,946
Current service cost	6,133	8,963	1,573	1,410
Interest cost	7,635	6,712	611	368
Plan participants' contributions	5,819	6,284	–	–
Benefits paid	(2,914)	(2,297)	(1,205)	(733)
Actuarial loss (gain)	10,778	(25,965)	674	995
<b>Benefit obligation, end of year</b>	<b>126,456</b>	<b>99,005</b>	<b>9,639</b>	<b>7,986</b>
<b>Change in plan assets</b>				
Fair market value of plan assets, beginning of year	92,243	90,147	–	–
Actual return on plan assets	15,293	(21,317)	–	–
Employer contribution	17,281	19,427	1,205	733
Plan participants' contributions	5,819	6,283	–	–
Benefits paid	(2,914)	(2,297)	(1,205)	(733)
<b>Fair market value of plan assets, end of year</b>	<b>127,722</b>	<b>92,243</b>	<b>–</b>	<b>–</b>
<b>Funded status, end of year</b>	<b>1,266</b>	<b>(6,762)</b>	<b>(9,639)</b>	<b>(7,986)</b>
Unamortized net actuarial loss	10,050	7,158	1,577	995
<b>Accrued benefit asset (liability)</b>	<b>11,316<sup>(1)</sup></b>	<b>396<sup>(1)</sup></b>	<b>(8,062)<sup>(2)</sup></b>	<b>(6,991)<sup>(2)</sup></b>

(1) The accrued benefit asset is included in other assets.

(2) The accrued benefit liability is included in other long-term liabilities.

Plan assets consist of the following:

	Pension Benefits	
	2009	2008
Canadian equity	34%	35%
Debt securities	37%	33%
International equity	24%	28%
Short-term and other	5%	4%
	<b>100%</b>	<b>100%</b>

The plan's assets are invested in a balanced fund and include no significant investment in Jazz, at the measurement date.

Weighted average assumptions used to determine the accrued benefit liability:

	Pension		Other Future Employee Benefits	
	2009	2008	2009	2008
Discount rate to determine accrued benefit obligations	6.76%	7.10%	5.75%	7.10%
Discount rate to determine the pension and benefit cost	7.10%	5.75%	7.10%	5.60%
Rate of compensation increase	4.00 – 5.00%	4.00 – 5.00%	2.30%	1.30%
Expected return on plan assets	7.10%	6.40%	n/a	n/a
Health care inflation – Select to determine accrued benefit obligation	n/a	n/a	7.9%	6.5%
Health care inflation – Select to determine pension and benefit cost	n/a	n/a	6.5%	7.1%

The health care inflation assumption was graded down in and after 2012 to 4.5% per annum

Jazz's net defined benefit pension plan and other future employee benefits expense is as follows:

	Pension		Other Future Employee Benefits	
	2009 \$	2008 \$	2009 \$	2008 \$
<b>Components of expense</b>				
Current service cost (including provision for plan expenses)	6,133	8,963	1,573	1,410
Interest cost	7,635	6,712	611	368
Actual return on plan assets	(15,293)	21,317	–	–
Actuarial (gain) loss	10,778	(25,965)	674	995
Costs arising in the period	9,253	11,027	2,858	2,773
Differences between costs arising in the period and costs recognized in the period in respect of:				
Return on plan assets	7,789	(27,772)	–	–
Actuarial (gain) loss	(10,682)	25,996	(582)	(995)
Net periodic pension and benefit cost recognized	6,360	9,251	2,276	1,778

## Note 20 Capital disclosures

Jazz's capital consists of cash, cash equivalents, long-term debt, convertible debentures and Unitholders' Equity (excluding accumulated other comprehensive income).

Jazz's objective when managing capital is to maximize long-term Unitholder value by:

- maintaining a flexible capital structure that optimizes the cost of capital at acceptable risk and preserves the ability to meet financial obligations; and
- providing a return to Unitholders by delivering monthly cash distributions.

In managing its capital structure, Jazz monitors performance throughout the year to ensure anticipated cash distributions, working capital requirements and maintenance capital expenditures are funded from operations, available cash on deposit and, where applicable, bank borrowings. Jazz will make adjustments to its capital structure to meet the objectives of the broader corporate strategy or in response to changes in economic conditions and risk. In order to maintain or adjust the capital structure, Jazz may adjust the amount of cash distributions to Unitholders, issue debt and/or issue, redeem or repurchase units.

The amount of cash distributions is determined by reference to available operating cash flows, net of property and equipment acquisition costs and adjustments made with reference to the definition of distributable cash in the limited partnership agreement.

Jazz monitors capital using a number of financial metrics, including (but not limited to):

- The Leverage Ratio defined as long-term debt <sup>(1)</sup> to earnings before interest, taxes, depreciation, amortization, and other non-operating income and expense (EBITDA);

- The Coverage Ratio defined as EBITDA to interest expense (defined as interest on capital leases, security deposits and the credit facility); and
- Minimum Cash Balance.

Jazz's measure of distributable cash and EBITDA may not be comparable to similar measures presented by other entities.

The following table illustrates the financial ratios calculated on a trailing twelve-month basis:

	Measure Targets	2009	2008
Leverage Ratio	<2.0x	1.40	0.79
Coverage Ratio	>3.5x	15.40	15.72
Minimum Cash Balance <sup>(2)</sup>	\$60,000	n/a	\$131,876

(1) Debt includes amounts related to term facility, promissory note from the Partnership to Jazz (eliminated upon consolidation), letters of credit and capital leases.

(2) This is a continuous measurement covenant. Jazz has been in compliance since the related agreement was entered into during the fourth quarter of 2007. During the fourth quarter of 2009, Jazz renegotiated the terms of the two aircraft leases under the common terms agreement that contained the minimum cash balance covenant and as a result, the minimum cash balance covenant is no longer applicable. A cash deposit equal to six months of lease payments has been lodged for each of the two leased aircraft.

As a result of the Canadian income trust taxation legislation passed in June 2007 and effective January 1, 2011, Jazz is subject to certain capital growth restrictions referred to as "normal growth" equity rules. These rules limit the amount of Unitholders' capital that can be issued by Jazz in 2010, based on Jazz's market capitalization on October 31, 2006.

On December 4, 2008, the Department of Finance (Canada) announced an acceleration of the safe harbour amounts for 2009 and 2010, such that after December 4, 2008, they became immediately available. The safe harbour rules remained cumulative such that after December 4, 2008, the maximum amount that could be issued by a SIFT under the safe harbour rules is 100% of its October 31, 2006 market capitalization, less the value of any units issued after October 31, 2006 (other than any issuances of units that would not be subject to the Normal Growth Guidelines).

As a result of the issuance of the \$86,250 in convertible debentures in the fourth quarter of 2009, Jazz's normal growth capital allowed in 2010 is \$145,750 (2009 – \$232,000)

If the maximum equity growth allowed is exceeded, Jazz may be subject to taxation prior to 2011.

In addition to growth capital restrictions, Jazz monitors its ownership levels, to the extent possible given the practical limitations, regarding beneficial ownership information. The Trust Indenture, under which Jazz was created, provides that no more than 49.9% of the Units of Jazz can be held by non-residents of Canada. The potential impact to Jazz of breaching this threshold could be the loss of mutual fund trust status, and being subject to taxation for the entire fiscal year in which the breach occurred. On the basis of information supplied by the transfer agent, at December 31, 2009, Jazz's best estimate of the ownership level by non-residents was 17% (2008 – 13%).

## **Note 21**

### **Financial instruments**

Jazz's financial instruments consist of cash and cash equivalents, accounts receivable, promissory note receivable, ABCP, accounts payable and accrued liabilities, obligations under capital leases, long-term debt and convertible debentures.

Jazz, through its financial assets and liabilities, 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 December 31, 2009, Jazz's investments consisted of bankers acceptances and bankers deposit notes issued by four schedule 1 banks and one R-1 high rated schedule 2 bank as well as a fully cashable GIC issued by a Schedule 1 bank. Jazz is exposed to interest rate fluctuation risk as a result of variable interest rates on its long-term debt. Jazz uses interest rate swaps to hedge its exposure to changes in interest rates, swapping its credit facility variable interest rate payments for fixed interest rate payments. Jazz has elected to designate its interest rate swaps as cash flow hedges and currently has no intention of settling these contracts early. Jazz entered into interest rate swap agreements with a third

party in respect of \$115,000 of debt which has effectively resulted in a fixed interest rate of 5.98% until February 2, 2010. If Jazz had settled these contracts at December 31, 2009, a payment of \$802 by Jazz would have resulted.

A 1% change in the interest rate would not have a significant impact on the net income of Jazz.

#### **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 on cash and cash equivalents 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 during the third quarter of 2007 to prohibit investment in all third party and bank sponsored ABCP. With respect to investments in ABCP, refer to discussion below.

The amount of accounts receivable disclosed in the balance sheet of \$59,044 is net of allowances for bad debts of \$32, estimated by management based on prior experience and its assessment of the current economic environment and the specific debtor. Approximately \$53,335 of receivables are with one company, Air Canada. Accordingly, Jazz is directly affected by the financial and operational strength of Air Canada. 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, as well as to demonstrate compliance with liquidity covenants included in financing contracts. Jazz monitors its cash balances and cash flows generated from operations to meet its liquidity requirements. As at December 31, 2009, Jazz had available \$31,759 in unutilized balance of the credit facilities and cash and cash equivalents of \$223,559. As at December 31, 2009, Jazz had authorized credit facilities of \$150,000 and drawings of \$115,000, against the facilities. Letters of credit totalling approximately \$3,241 (December 31, 2008 – \$3,382) have been issued as security for groundhandling and airport fee contracts, lease payments on rental space and aircraft, and certain employee benefits. The letters of credit are drawn against the unutilized balance of the credit facilities.

#### **Currency risk**

Jazz receives revenue and incurs expenses in US and Canadian currency, and as such, is subject to fluctuations as a result of foreign exchange rate variations. Jazz manages its exposure to currency risk by billing for its services within the CPA in the underlying currency related to the 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 so are subject to larger unrealized gains or losses. Jazz minimizes its currency risk by maintaining a balance of US dollars which is used to pay down

US denominated liabilities and replenishes the balance through US denominated revenues. The amount of US dollar denominated assets was \$63,118 and US denominated liabilities was \$59,693 at December 31, 2009. A 1¢ change in the US exchange rate would result in a change in the unrealized gain or loss of approximately \$34.

### Fair value of financial instruments

The carrying amounts reported in the balance sheet for accounts receivable, and accounts payable and accrued liabilities approximate fair values based on the immediate or short-term maturities of these financial instruments. Due to current market conditions and related increases in risk premiums on credit facilities, management has estimated the fair value of the credit facilities at December 31, 2009 to be \$115,000. The fair value of convertible debentures are determined by adding the market premium at December 31, 2009 to the amortized cost base. Financial assets included in the balance sheet include ABCP with an estimated fair value of \$1,053 (see below for discussion on determination of fair value of ABCP).

### Carrying amounts and fair values

The fair values of financial assets and liabilities, together with the carrying amounts included in the consolidated balance sheets, are as follows:

	December 31, 2009		December 31, 2008	
	Carrying Amount \$	Fair Value \$	Carrying Amount \$	Fair Value \$
<b>Financial assets</b>				
<i>Held for trading, carried at fair value</i>				
Cash and cash equivalents	223,559	223,559	131,876	131,876
Asset backed commercial paper	1,053	1,053	2,009	2,009
Loans and receivables, carried at amortized cost				
Accounts receivable <sup>(1)</sup>	55,518	55,518	69,475	69,475
Promissory note	–	–	419	419
<b>Financial liabilities</b>				
<i>Other financial liabilities, carried at amortized cost</i>				
Accounts payable and accrued liabilities (includes current portion of obligations under capital leases) <sup>(1)</sup>	171,833	171,833	181,199	181,199
Distributions payable	6,143	6,143	10,296	10,296
Long-term debt	114,706	115,000	114,729	110,000
Obligations under capital leases	15,097	15,097	20,581	20,581
Convertible debentures	78,180	80,142	–	–

(1) Assets and liabilities, such as commodity taxes, that are not contractual and that arise as a result of statutory requirements imposed by governments, do not meet the definition of financial assets or financial liabilities and are therefore excluded.

### Fair value hierarchy

Financial instruments recorded at fair value on the balance sheet are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

**Level 1** – valuation based on quoted prices observed in active markets for identical assets or liabilities.

**Level 2** – valuation techniques based on inputs that are quoted prices of similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; inputs other than quoted prices used in a valuation model that are observable for that instrument; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

**Level 3** – valuation techniques with significant unobservable market inputs.

A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

The following table presents the financial instruments recorded at fair value in the consolidated balance sheet as at December 31, 2009, classified using the fair value hierarchy described above:

	Level 1 \$	Level 2 \$	Level 3 \$
<b>Financial assets</b>			
Cash and cash equivalents	223,559	–	–
Asset backed commercial paper	–	–	1,053
Total	223,559	–	1,053

The ABCP classified as level three is a financial security that currently has no active trading market. Valuation is done based on limited available market information, maturity dates and expected return of capital on a discounted basis. During the year ended December 31, 2009, a valuation gain of \$650 (2008 – loss of \$2,985) was recorded.

## **Note 22**

### **Contingencies**

The Jazz Declaration of Trust provides that the Trustees will act honestly and in good faith with a view to the best interest of Jazz and in connection with that duty, will exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. The Jazz Declaration of Trust provides that each Trustee will be entitled to indemnification from Jazz in respect of the exercise of the Trust's power and the discharge of the Trustee's duties, provided that the Trustee acted honestly and in good faith with a view to the best interests of all Unitholders, or in the case of a criminal or administrative action proceeding that is enforced by a monetary penalty, where the Trustee had reasonable grounds for believing that his/her conduct was lawful. The Trustees are covered by directors' and officers' liability insurance. No claims with respect to such occurrences have been made and, as such, no amount has been recorded in these financial statements with respect to these indemnifications.

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 counter-claimed 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 \$850,000 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 against Jazz and Air Canada was stayed pending the outcome of the proceeding in Federal Court. Jazz is continuing its proceeding in the Federal Court of Canada against the TPA, in which the Porter Defendants intervened and have been made parties. Jazz maintains that Porter's counterclaims in both jurisdictions are without merit. The counterclaims are currently being vigorously contested by Jazz in court. If Jazz is not successful in the Federal Court of Canada action, it will not have fair and equal access to the TCCA. If Jazz is not successful in defending the counter-claims, it could be subject to a material damages award.

Various other lawsuits and claims that have arisen in the normal course of business are pending by and against Jazz and provisions have been recorded where appropriate. It is the opinion of management that final determination of these claims will not have a material adverse effect on the financial position or the results of Jazz.

Jazz GP has agreed to indemnify its directors and officers against certain costs and damages incurred by the directors and officers as a result of lawsuits or any other judicial, administrative

or investigative proceeding in which the directors and officers are sued as a result of their service. The directors and officers are covered by directors' and officers' liability insurance. No amount has been recorded in these financial statements with respect to the indemnification agreements.

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

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

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

The maximum amount payable, if any, under the foregoing indemnities cannot be reasonably estimated. Jazz carries or is otherwise the beneficiary of various insurance policies in respect of various risks applicable to the business (including in respect of tort liability and certain contractual indemnities).

## **Note 23**

### **Subsequent event**

The credit facilities matured on February 1, 2010 and all amounts owing thereunder were repaid and the related security was released. As a result, Jazz has all of its assets unencumbered (excluding \$3,312 in cash encumbered in support of issued letters of credit) 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 \$115,000. The letters of credit remain outstanding and have been cash collateralized.



## 2010 UNITHOLDER INFORMATION

### Officers

Joseph D. Randell  
*President and Chief Executive Officer*

Colin Copp  
*Chief Administrative Officer*

Jolene Mahody  
*Chief Operating Officer*

Allan Rowe  
*Chief Financial Officer*

Richard Flynn  
*Vice President, Finance*

Steven Linthwaite  
*Vice President, Operations*

Barbara Snowdon  
*General Counsel and Corporate Secretary*

Richard Steer  
*Vice President, Maintenance and Engineering*

Scott Tapson  
*Vice President, Business Development*

### Directors of Jazz Air Holding GP Inc.

Richard H. McCoy, *Chairman*  
Gary M. Collins  
Sydney John Isaacs  
Katherine M. Lee  
G. Ross MacCormack  
John T. McLennan  
Joseph D. Randell  
Bryan L. Rishforth

### Trustees of Jazz Air Trust and Jazz Air Income Fund

Richard H. McCoy, *Chairman*  
Gary M. Collins  
Sydney John Isaacs  
Katherine M. Lee  
G. Ross MacCormack  
John T. McLennan  
Joseph D. Randell

### Annual General Meeting

Thursday, May 13, 2010 at 4:00 PM PST  
Morris J. Wosk Centre for Dialogue  
Simon Fraser University, Vancouver  
580 West Hastings Street  
Vancouver, British Columbia

### Transfer Agent

CIBC Mellon Trust Company  
Telephone 1-800-387-0825  
Halifax, Montreal, Toronto, Calgary, Vancouver

### Legal Counsel

Osler, Hoskin & Harcourt LLP

### Registered office of Jazz Air Income Fund, Jazz Air Trust, Jazz Air LP and Jazz Air Holding GP Inc.

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flyjazz.ca

**Vision & Values** At Jazz, our vision is to be the industry leader in regional airline services.

Our employees take ownership by making safety the top priority, focusing on customers, acting with integrity, respecting diversity, supporting the team, celebrating excellence, and being environmentally responsible.

**Jazz**