

Consolidated Balance Sheets

<i>(Unaudited)</i> <i>(amounts in millions of Canadian dollars)</i>	As at June 30 2008	As at March 31 2008
Assets		
<i>Current assets</i>		
Cash and cash equivalents	\$ 147.7	\$ 255.7
Accounts receivable (Note 6)	241.1	255.0
Inventories	277.0	229.9
Prepaid expenses	28.3	32.7
Income taxes recoverable	39.1	39.0
Future income taxes	11.3	14.1
	\$ 744.5	\$ 826.4
Property, plant and equipment, net	1,081.3	1,046.8
Future income taxes	75.7	64.3
Intangible assets	77.1	62.0
Goodwill	130.0	115.5
Other assets	135.8	138.2
	\$ 2,244.4	\$ 2,253.2
Liabilities and shareholders' equity		
<i>Current liabilities</i>		
Accounts payable and accrued liabilities	\$ 416.8	\$ 482.7
Deposits on contracts	197.6	209.3
Current portion of long-term debt	100.4	27.3
Future income taxes	15.2	16.8
	\$ 730.0	\$ 736.1
Long-term debt	301.8	352.5
Deferred gains and other long-term liabilities	180.1	184.9
Future income taxes	44.8	31.2
	\$ 1,256.7	\$ 1,304.7
Shareholders' equity		
Capital stock	\$ 428.4	\$ 418.9
Contributed surplus	8.8	8.3
Retained earnings	683.0	644.5
Accumulated other comprehensive loss	(132.5)	(123.2)
	\$ 987.7	\$ 948.5
	\$ 2,244.4	\$ 2,253.2

The accompanying notes form an integral part of these Consolidated Financial Statements.

Consolidated Statements of Earnings

(Unaudited)

three months ended June 30

(amounts in millions of Canadian dollars, except per share amounts)

	2008	2007
Revenue	\$ 392.1	\$ 358.3
Earnings before interest and income taxes (Note 12)	\$ 71.3	\$ 58.0
Interest expense, net (Note 5)	4.3	2.6
Earnings before income taxes	\$ 67.0	\$ 55.4
Income tax expense	20.0	16.7
Earnings from continuing operations	\$ 47.0	\$ 38.7
Results of discontinued operations	(0.9)	–
Net earnings	\$ 46.1	\$ 38.7
Basic and diluted earnings per share from continuing operations	\$ 0.18	\$ 0.15
Basic and diluted earnings per share	\$ 0.18	\$ 0.15
Weighted average number of shares outstanding (basic)	254.3	252.4
Weighted average number of shares outstanding (diluted)	255.1	253.8

The accompanying notes form an integral part of these Consolidated Financial Statements.

Consolidated Statements of Changes in Shareholders' Equity

(Unaudited)

three months ended June 30, 2008

(amounts in millions of Canadian dollars, except number of shares)

	Number of Shares	Common Shares Stated Value	Contributed Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balances, beginning of period	253,969,836	\$ 418.9	\$ 8.3	\$ 644.5	\$ (123.2)	\$ 948.5
Stock options exercised	845,875	8.4	—	—	—	8.4
Transfer upon exercise of stock options	—	0.6	(0.6)	—	—	—
Stock dividends	41,980	0.5	—	(0.5)	—	—
Stock-based compensation	—	—	1.1	—	—	1.1
Net earnings	—	—	—	46.1	—	46.1
Dividends	—	—	—	(7.1)	—	(7.1)
Other comprehensive loss	—	—	—	—	(9.3)	(9.3)
Balances, end of period	254,857,691	\$ 428.4	\$ 8.8	\$ 683.0	\$ (132.5)	\$ 987.7

(Unaudited)

three months ended June 30, 2007

(amounts in millions of Canadian dollars, except number of shares)

	Number of Shares	Common Shares Stated Value	Contributed Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balances, beginning of period	251,960,449	\$ 401.7	\$ 5.7	\$ 510.2	\$ (87.7)	\$ 829.9
Stock options exercised	1,455,520	11.6	—	—	—	11.6
Transfer upon exercise of stock options	—	1.5	(1.5)	—	—	—
Stock dividends	5,539	0.1	—	(0.1)	—	—
Stock-based compensation	—	—	0.6	—	—	0.6
Cumulative effect of implementing accounting standards (Note 2)	—	—	—	(8.3)	(3.5)	(11.8)
Net earnings	—	—	—	38.7	—	38.7
Dividends	—	—	—	(2.4)	—	(2.4)
Other comprehensive loss	—	—	—	—	(46.4)	(46.4)
Balances, end of period	253,421,508	\$ 414.9	\$ 4.8	\$ 538.1	\$ (137.6)	\$ 820.2

The accompanying notes form an integral part of these Consolidated Financial Statements.

Consolidated Statements of Comprehensive Income (Loss)

*(Unaudited)**three months ended June 30**(amounts in millions of Canadian dollars)*

	2008	2007
Net earnings	\$ 46.1	\$ 38.7
Other comprehensive income (loss), net of income taxes:		
Foreign currency translation adjustment		
Net foreign exchange losses on translation of financial statements of self-sustaining foreign operations	\$ (13.1)	\$ (67.5)
Net change in gains on certain long-term debt denominated in foreign currency and designated as hedges on net investments of self-sustaining foreign operations	0.3	8.3
Income tax adjustment	–	0.5
	\$ (12.8)	\$ (58.7)
Net changes in cash flow hedge		
Net change in gains on derivative items designated as hedges of cash flows	\$ 8.1	\$ 24.0
Reclassifications to income or to the related non-financial assets or liabilities	(3.1)	(5.9)
Income tax adjustment	(1.5)	(5.8)
	\$ 3.5	\$ 12.3
Total other comprehensive loss	\$ (9.3)	\$ (46.4)
Comprehensive income (loss)	\$ 36.8	\$ (7.7)

The accompanying notes form an integral part of these Consolidated Financial Statements.

Consolidated Statement of Accumulated Other Comprehensive Loss

<i>(Unaudited)</i> <i>as at June 30, 2008</i> <i>(amounts in millions of Canadian dollars)</i>	Foreign Currency Translation Adjustment	Cash Flow Hedge	Accumulated Other Comprehensive Loss
Balance in accumulated other comprehensive loss at beginning of the period	\$ (122.8)	\$ (0.4)	\$ (123.2)
Details of other comprehensive loss:			
Net change in gains (losses)	(12.8)	8.1	(4.7)
Reclassification to income or to the related non-financial assets or liabilities	–	(3.1)	(3.1)
Income tax adjustment	–	(1.5)	(1.5)
Total other comprehensive loss	\$ (12.8)	\$ 3.5	\$ (9.3)
Balance in accumulated other comprehensive loss at end of period	\$ (135.6)	\$ 3.1	\$ (132.5)

The accompanying notes form an integral part of these Consolidated Financial Statements.

Consolidated Statements of Cash Flows

(Unaudited)

three months ended June 30

(amounts in millions of Canadian dollars)

	2008	2007
Operating activities		
Net earnings	\$ 46.1	\$ 38.7
Results of discontinued operations	0.9	–
Earnings from continuing operations	47.0	38.7
Adjustments to reconcile earnings to cash flows from operating activities:		
Depreciation	15.7	14.6
Financing cost amortization	0.2	0.2
Amortization and write down of intangible and other assets	4.2	3.9
Future income taxes	5.7	4.8
Investment tax credits	3.4	3.8
Stock-based compensation plans	(4.2)	(2.9)
Employee future benefit – net	0.2	(0.1)
Other	(1.8)	6.2
Changes in non-cash working capital (Note 7)	(99.1)	(97.9)
Net cash used in operating activities	(28.7)	(28.7)
Investing activities		
Business acquisitions (net of cash and cash equivalents acquired) (Note 3)	(38.8)	(38.9)
Capital expenditures	(38.4)	(32.7)
Deferred development costs	(1.9)	(4.8)
Deferred pre-operating costs	(0.2)	(0.3)
Other	(1.1)	(2.5)
Net cash used in investing activities	(80.4)	(79.2)
Financing activities		
Net borrowing under revolving unsecured credit facilities	–	15.0
Proceeds from long-term debt, net of transaction costs and debt basis adjustment	8.6	84.2
Reimbursement of long-term debt	(5.5)	(4.3)
Dividends paid	(7.1)	(2.4)
Common stock issuance	8.4	11.6
Other	(1.0)	(4.7)
Net cash provided by financing activities	3.4	99.4
Effect of foreign exchange rate changes on cash and cash equivalents	(2.3)	(6.7)
Net decrease in cash and cash equivalents	(108.0)	(15.2)
Cash and cash equivalents at beginning of period	255.7	150.2
Cash and cash equivalents at end of period	\$ 147.7	\$ 135.0

The accompanying notes form an integral part of these Consolidated Financial Statements.

Notes to the Consolidated Financial Statements (Unaudited)

NOTE 1 – NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Nature of operations

CAE Inc. (or the Company) designs, manufactures and supplies simulation equipment and services and develops integrated training solutions for the military, commercial airlines, business aircraft operators and aircraft manufacturers. CAE's flight simulators replicate aircraft performance in normal and abnormal operations as well as a comprehensive set of environmental conditions utilizing visual systems that contain an extensive database of airports, other landing areas, flying environments, motion and sound cues to create a fully immersive training environment. The Company offers a full range of flight training devices based on the same software used on its simulators. The Company also operates a global network of training centres in locations around the world.

The Company's operations are managed through four segments:

- (i) Simulation Products/Civil – Designs, manufactures and supplies civil flight simulators, training devices and visual systems;
- (ii) Simulation Products/Military – Designs, manufactures and supplies advanced military training equipment and software tools for air forces, armies and navies;
- (iii) Training & Services/Civil – Provides business and commercial aviation training for all flight and ground personnel and all associated services;
- (iv) Training & Services/Military – Supplies turnkey training services, support services, systems maintenance and modelling and simulation solutions.

Seasonality and cyclicity of the business

The Company's business operating segments are affected in varying degrees by market cyclicity and/or seasonality. As such, operating performance over a given interim period should not necessarily be considered indicative of full fiscal year performance.

The Simulation Products/Civil segment sells equipment directly to airlines and to the extent that the entire commercial airline industry is affected by cycles of expansion and contraction, the Company's performance will also be affected. The Training & Services/Civil segment activities are affected by the seasonality of its industry – in times of peak travel (such as holidays), airline and business jet pilots are generally occupied flying aircraft rather than attending training sessions. The opposite also holds true – slower travel periods tend to be more active training periods for pilots. Therefore, the Company has historically experienced greater demand for training services in the first and fourth quarters of the fiscal year and lower demand during the second and third quarters.

Order intake for the Military segments can be impacted by the unique nature of military contracts and the irregular timing in which they are awarded.

Use of estimates

The preparation of consolidated financial statements in conformity with GAAP requires CAE's management (Management) to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses for the period reported. Management reviews its estimates on an ongoing basis, particularly as they relate to accounting of long-term contracts, useful lives, employee future benefits, income taxes, impairment of long-lived assets, fair value of certain financial instruments, goodwill and intangible, based on Management's best knowledge of current events and actions that the Company may undertake in the future. Actual results could differ from those estimates; significant changes in estimates and/or assumptions could result in the impairment of certain assets.

Generally accepted accounting principles and financial statement presentation

These interim unaudited consolidated financial statements have been prepared, in all material respects, in accordance with generally accepted accounting principles in Canada (GAAP) as defined by the Canadian Institute of Chartered Accountants (CICA).

These consolidated financial statements comply with generally accepted accounting principles applicable to interim financial statements and, except as otherwise indicated hereunder, have been prepared on a basis consistent with the Company's annual consolidated financial statements for the year ended March 31, 2008, except for the adoption of the new accounting standards described in Note 2.

These consolidated statements do not include all of the disclosures applicable to annual consolidated financial statements; for a full description of the Company's accounting policies, refer to the Company's annual consolidated financial statements for the year ended March 31, 2008 available on-line at www.sedar.com, at www.sec.gov, as well as on the Company's website at www.cae.com. While Management believes that the disclosures presented are adequate and that the disclosures highlight all material changes during the quarter, these interim consolidated financial statements should be read in conjunction with the most recent annual consolidated financial statements.

Certain comparative figures have been reclassified to conform with the presentation adopted during the current year.

Except where otherwise noted, all amounts in these consolidated financial statements are expressed in Canadian dollars.

Basis of consolidation

The consolidated financial statements include the accounts of CAE Inc. and all majority-owned subsidiaries and variable interest entities for which the Company is the primary beneficiary. They also include the Company's proportionate share of assets, liabilities and earnings of joint ventures in which the Company has an interest. All significant intercompany accounts and transactions have been eliminated. Investments over which the Company exercises significant influence are accounted for using the equity method and portfolio investments are accounted at fair value unless there is no readily available market value.

NOTE 2 – CHANGE IN ACCOUNTING POLICIES

Implemented in fiscal 2009

Financial instruments – disclosures and presentation

Effective April 1, 2008, the Company adopted CICA Handbook Section 3862, *Financial instruments – Disclosures* and Section 3863, *Financial instruments – Presentation*. Under CICA 3862, an entity is required to disclose information that enables users to evaluate the significance of a financial instrument on an entity's financial position and performance, to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the consolidated balance sheet date, and to evaluate how the entity manages those risks.

CICA 3863 establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equities, the classification of related interest, dividends, gains and losses, and circumstances in which financial assets and financial liabilities are offset.

The adoption of these standards did not have any impact on the classification and measurement of the Company's financial statements. The new disclosures pursuant to these new Handbook Sections are included in Note 11.

Capital disclosures

Effective April 1, 2008, the Company adopted CICA Handbook Section 1535, *Capital Disclosures*, which establishes guidelines for the disclosure of information regarding an entity's capital and how it is managed. This standard requires disclosure of an entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital and whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. The new disclosures are included in Note 10.

Inventories

Effective April 1, 2008, the Company adopted CICA Handbook Section 3031, *Inventories*, which replaces existing Section 3030 with the same title. The new section specifies the measurement of inventory at the lower of cost and net realizable value with the possibility of reversing previous write downs. It provides more extensive guidance on the determination of cost including allocation of overhead, and narrows the permitted cost formula to apply for the recognition to expense as well as expanding disclosure requirements. There were no adjustments to the Company's consolidated financial statements upon adoption of this new standard.

The amount of inventory, excluding long-term contracts, recognized as cost of sales for the three months ended June 30, 2008 was as follows:

<i>(Unaudited)</i>		2008
<i>three months ended June 30</i>		
<i>(amounts in millions)</i>		
Work in progress	\$	17.6
Raw materials, supplies and manufacturing products		16.0
	\$	33.6

The carrying amount of inventories pledged as security for loans was \$2.5 million as at June 30, 2008.

Implemented in fiscal 2008

Accounting changes

On April 1, 2007, the Company adopted CICA Handbook Section 1506, *Accounting Changes*. This standard establishes criteria for changing accounting policies, along with the accounting treatment and disclosure regarding changes in accounting policies, estimates and correction of errors. The application of this revised standard had no effect to the Company's consolidated financial statements.

Financial instrument and hedging relationships

On April 1, 2007, the Company adopted CICA Handbook Section 1530, *Comprehensive Income*, Section 3855, *Financial Instruments – Recognition and Measurement*, and Section 3865, *Hedges*, which provided accounting guidelines for recognition and measurement of financial assets, financial liabilities and non-financial derivatives, and described when and how hedge accounting may be applied.

The Company's adoption of these financial instruments standards resulted in changes in accounting for financial instruments and hedges. The impact of these new standards is presented as a transitional adjustment in opening retained earnings and opening accumulated other comprehensive loss, as applicable as at April 1st, 2007. These standards were applied without restatement of prior periods, with the exception of the reclassification of the foreign currency translation adjustment, which is now disclosed as part of accumulated other comprehensive loss. All other transitional adjustments ensuing from these standards resulted in a decrease in retained earnings, net of income taxes, of \$8.3 million and a decrease in accumulated other comprehensive loss, net of income taxes, of \$3.5 million as at April 1st, 2007 as more fully described in Note 2 of the annual consolidated financial statements for the year ended March 31, 2008.

NOTE 3 – BUSINESS ACQUISITIONS

In June 2008, the Company acquired Sabena Flight Academy (Sabena) for a total cost, including acquisition costs, of \$66.9 million composed primarily of cash and assumed debt. Sabena offers cadet training, advanced training and aviation consulting for airlines and self-sponsored pilot candidates. The total costs do not include potential additional consideration of \$6.3 million that is contingent on certain conditions being satisfied, which, if met, would be recorded as additional goodwill.

Goodwill recognized for this transaction, which is not deductible for tax purposes, amounts to \$15.3 million. As well, a customer relationship intangible asset in the amount of \$15.6 million has been recognized regarding this transaction. The acquisition was accounted for under the purchase method and the operating results have been included in the consolidated results on the Company since the date of acquisition. The net assets of Sabena are included in the Training & Services/Civil segment. The allocation of the purchase price is preliminary and is expected to be completed in the near future.

NOTE 4 – INVESTMENTS IN JOINT VENTURES

The Company's consolidated balance sheets and consolidated statements of earnings and cash flows include, on a proportionate consolidation basis, the impact of its joint venture companies of Zhuhai Xiang Yi Aviation Technology Company Limited – 49%, Helicopter Training Media International GmbH – 50%, Helicopter Flight Training Services GmbH – 25%, the Emirates-CAE Flight Training centre – 50%, Embraer CAE Training Services LLC – 49% (starting fiscal 2008), Hatsoff Helicopter Training Private Limited – 50% (starting fiscal 2008), National Flying Training Institute Private Limited – 51% (starting fiscal 2009), and CAE Bangalore training centre – 50% (starting fiscal 2009).

Except for the Helicopter Training Media International GmbH joint venture, whose operations are essentially focused on designing, manufacturing and supplying advanced helicopter military training product applications, the other joint venture companies' operations are focused on providing civil and military aviation training and related services.

The impact on the Company's consolidated financial statements from all joint ventures is as follows:

<i>(Unaudited)</i> <i>(amounts in millions)</i>	As at June 30 2008	As at March 31 2008
Assets		
Current assets	\$ 52.7	\$ 33.8
Property, plant and equipment and other non-current assets	177.8	163.1
Liabilities		
Current liabilities	23.6	22.9
Long-term debt (including current portion)	83.4	75.9
Deferred gains and other long-term liabilities	1.7	–

<i>(Unaudited)</i> <i>three months ended June 30</i> <i>(amounts in millions)</i>	2008	2007
Earnings		
Revenue	\$ 13.7	\$ 13.8
Net earnings	4.3	2.6
Segmented operating income		
Simulation Products/Military	1.0	0.6
Training and Services/Civil	3.9	2.7
Training and Services/Military	(0.2)	(0.1)

<i>(Unaudited)</i> <i>three months ended June 30</i> <i>(amounts in millions)</i>	2008	2007
Cash flows provided by (used in):		
Operating activities	\$ 6.4	\$ 7.6
Investing activities	(4.3)	(5.1)
Financing activities	8.2	8.8

NOTE 5 – INTEREST EXPENSE, NET

Details of interest expense (income) are as follows:

<i>(Unaudited)</i> <i>three months ended June 30</i> <i>(amounts in millions)</i>	2008	2007
Long-term debt interest expense	\$ 6.1	\$ 4.3
Amortization of deferred financing costs and other	0.8	0.6
Interest capitalized	(1.3)	(1.0)
Interest on long-term debt	\$ 5.6	\$ 3.9
Interest income	\$ (0.7)	\$ (0.7)
Other interest expense (income), net	(0.6)	(0.6)
Interest income, net	\$ (1.3)	\$ (1.3)
Interest expense, net	\$ 4.3	\$ 2.6

NOTE 6 – ACCOUNTS RECEIVABLE

Accounts receivable are carried on the consolidated balance sheet net of allowance for doubtful accounts. This provision is established based on the Company's best estimates regarding the ultimate recovery of balances for which collection is uncertain. Uncertainty of ultimate collection may become apparent from various indicators, such as a deterioration of the credit situation of a given client and of delay in collection when aging of invoices exceeds the contractually agreed upon payment terms. Management regularly reviews accounts receivable, monitors past due balances and assesses the appropriateness of the allowance for doubtful accounts.

Details of accounts receivable were as follows:

<i>(Unaudited)</i> <i>(amounts in millions)</i>	As at June 30 2008	As at March 31 2008
Past due trade receivables		
1-30 days	\$ 37.3	\$ 38.0
31-60 days	16.1	10.7
61-90 days	9.4	6.3
Greater than 90 days	19.1	20.6
Total	\$ 81.9	\$ 75.6
Allowance for doubtful accounts	\$ (8.8)	\$ (7.4)
Current trade receivables	69.6	81.2
Accrued receivables	52.8	48.5
Derivative assets	14.7	17.2
Other receivables	30.9	39.9
Total accounts receivable	\$ 241.1	\$ 255.0

Changes in the allowance for doubtful accounts were as follows as at June 30:

<i>(Unaudited)</i> <i>three months ended June 30</i> <i>(amounts in millions)</i>	2008
Balance at beginning of period	\$ (7.4)
Additions	(2.9)
Amounts charged off	1.4
Foreign exchange	0.1
Balance at end of period	\$ (8.8)

NOTE 7 – SUPPLEMENTARY INFORMATION

(Unaudited)
three months ended June 30
(amounts in millions)

	2008	2007
Cash provided by (used in) non-cash working capital:		
Accounts receivable	\$ 21.5	\$ (41.6)
Inventories	(38.1)	(2.5)
Prepaid expenses	5.2	0.3
Income taxes recoverable	(3.2)	(9.3)
Accounts payable and accrued liabilities	(73.4)	(63.9)
Deposits on contracts	(11.1)	19.1
Changes in non-cash working capital	\$ (99.1)	\$ (97.9)
Supplemental cash flow disclosure:		
Interest paid	\$ 8.8	\$ 6.8
Income taxes paid (received)	\$ 9.2	\$ 11.3
Supplemental statements of earnings disclosure:		
Foreign exchange gains (losses) on financial instruments recognized in earnings:		
Loans and receivables	\$ (1.6)	\$ (7.3)
Financial assets and financial liabilities required to be classified as held for trading	(0.2)	(4.3)
Other financial liabilities	2.4	9.4
Foreign exchange gain (loss)	\$ 0.6	\$ (2.2)

NOTE 8 – GOVERNMENT COST SHARING**Project Phoenix**

The following table provides information regarding contributions recognized and amounts not yet received for the aggregate project:

(Unaudited)
three months ended June 30
(amounts in millions)

	2008
Outstanding contribution receivable, beginning of period	\$ 24.2
Contributions	11.2
Payments received	(16.2)
Outstanding contribution receivable, end of period	\$ 19.2

Aggregate information about programs

The following table provides information on the aggregate contributions recognized and aggregate royalty expenditures recognized for all programs:

<i>(Unaudited)</i> three months ended June 30 <i>(amounts in millions)</i>	2008	2007
Contributions credited to capitalized costs:		
Project Phoenix	\$ 2.7	\$ 4.3
Contributions credited to income:		
Project Phoenix	8.5	9.5
Total contributions:		
Project Phoenix	\$ 11.2	\$ 13.8
Royalty expenses:		
Project Phoenix	\$ –	\$ –
Previous programs	2.6	2.1

NOTE 9 – EMPLOYEE FUTURE BENEFITS

The total benefit cost for the periods ended June 30 includes the following components:

<i>(Unaudited)</i> three months ended June 30 <i>(amounts in millions)</i>	2008	2007
Current service cost	\$ 2.2	\$ 2.1
Interest cost on projected pension obligations	3.3	3.2
Expected return on plan assets	(3.3)	(3.2)
Amortization of net actuarial loss	0.5	0.6
Amortization of past service costs	0.1	0.1
Net pension expense	\$ 2.8	\$ 2.8

NOTE 10 – CAPITAL MANAGEMENT

The Company's objectives when managing capital are threefold:

- (i) Optimize the use of debt in relation to managing the cost of capital of the Company;
- (ii) Keep the debt level at an amount where the Company's financial strength and credit quality is maintained in order to withstand economic cycles;
- (iii) Provide the Company's shareholders with an appropriate rate of return on their investment.

The Company sets the amount of capital in proportion to risk. The Company manages the capital structure and makes corresponding adjustments based on changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, or use cash to reduce debt.

In view of this, the Company monitors its capital on the basis of the adjusted net debt to capital ratio. This ratio is calculated as adjusted net debt divided by the sum of the adjusted net debt and equity. Adjusted net debt is calculated as total debt (as presented in the consolidated balance sheet and including non-recourse debt) added to the present value of operating leases (held off balance sheet) less cash and cash equivalents. Equity comprises all components of shareholders' equity (i.e. capital stock, contributed surplus, retained earnings and accumulated other comprehensive loss).

The level of debt versus equity in the capital structure will be maintained at levels appropriate for a given economic cycle and according to the Company's growth strategy relative to the different business segments and therefore adjusted over time to appropriate levels ensuring the achievement of the objectives as stated above. The ratios as at June 30, 2008 and as at March 31, 2008 were as follows:

<i>(Unaudited)</i> <i>(amounts in millions)</i>	As at June 30 2008	As at March 31 2008
Total debt	\$ 402.2	\$ 379.8
Add: Present value of operating leases (held off balance sheet)	199.6	200.2
Less: Cash and cash equivalents	(147.7)	(255.7)
Adjusted net debt	\$ 454.1	\$ 324.3
Shareholders' equity	\$ 987.7	\$ 948.5
Adjusted net debt : shareholders' equity	31:69	25:75

The increase in the adjusted net debt to equity ratio during first quarter of fiscal 2009 resulted primarily from the increase in net debt that occurred as a result of cash used for the acquisition of Sabena Flight Academy and other general corporate and working capital purposes.

In the first quarter of fiscal 2009, the Board of Directors approved an increase in the quarterly dividend per share to \$0.03 from \$0.01.

The Company has certain debt agreements which require the maintenance of a certain level of capital. As at June 30, 2008, the Company is compliant with all its capital maintenance covenants.

NOTE 11 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT**Financial instruments**

The carrying values and fair values of financial instruments, by class, are as follows:

(Unaudited)
as at June 30, 2008
(amounts in millions)

	Held for Trading	Available for Sale	Loans & Receivables	Carrying Value	Fair Value
				Total	
Financial assets					
Cash and cash equivalents	\$ 147.7	\$ –	\$ –	\$ 147.7	\$ 147.7
Accounts receivable ^(a)	–	–	202.8 ^(b)	202.8	202.8
Other assets ^(a)	10.1 ^(c)	22.5 ^(d)	1.4 ^(e)	34.0	34.0
Derivative assets	9.9 ^(f)	–	–	9.9	9.9
	\$ 167.7	\$ 22.5	\$ 204.2	\$ 394.4	\$ 394.4

	Held for Trading	Other Financial Liabilities	Carrying Value	Fair Value
			Total	
Financial liabilities				
Accounts payable and accrued liabilities ^(a)	–	\$ 290.4 ^(g)	\$ 290.4	\$ 290.4
Total long-term debt	–	402.2	402.2	409.7
Deferred gains and other long-term liabilities ^(a)	–	0.5 ^(h)	0.5	0.5
Derivative liabilities	14.5 ^(f)	–	14.5	14.5
	\$ 14.5	\$ 693.1	\$ 707.6	\$ 715.1

(a) Excludes derivative financial instruments that have been presented separately.

(b) Includes trade receivables, accrued receivables and certain other receivables.

(c) Includes restricted cash.

(d) Represents the Company's investment in CVS Leasing Ltd.

(e) Includes long-term receivables.

(f) Includes embedded derivatives accounted for separately and derivatives not designated in a hedging relationship but that are economic hedges and excludes derivatives that are designated and effective hedging instruments.

(g) Includes trade accounts payable, accrued liabilities, interest payable and certain payroll-related liabilities.

(h) Includes a long-term payable that meets the definition of a financial liability.

(Unaudited)
as at March 31, 2008
(amounts in millions)

	Held for Trading	Available for Sale	Loans & Receivables	Carrying Value	Fair Value
				Total	
Financial assets					
Cash and cash equivalents	\$ 255.7	\$ –	\$ –	\$ 255.7	\$ 255.7
Accounts receivable ^(a)	–	–	205.5 ^(b)	205.5	205.5
Other assets ^(a)	8.6 ^(c)	22.6 ^(d)	1.2 ^(e)	32.4	32.4
Derivative assets	12.0 ^(f)	–	–	12.0	12.0
	\$ 276.3	\$ 22.6	\$ 206.7	\$ 505.6	\$ 505.6

	Held for Trading	Other Financial Liabilities	Carrying Value	Fair Value
			Total	
Financial liabilities				
Accounts payable and accrued liabilities ^(a)	\$ –	\$ 346.9 ^(g)	\$ 346.9	\$ 346.9
Total long-term debt	–	379.8	379.8	389.3
Deferred gains and other long-term liabilities ^(a)	–	0.5 ^(h)	0.5	0.5
Derivative liabilities	15.5 ^(f)	–	15.5	15.5
	\$ 15.5	\$ 727.2	\$ 742.7	\$ 752.2

^(a) Excludes derivative financial instruments that have been presented separately.

^(b) Includes trade receivables, accrued receivables and certain other receivables.

^(c) Includes restricted cash.

^(d) Represents the Company's investment in CVS Leasing Ltd.

^(e) Includes long-term receivables.

^(f) Includes embedded derivatives accounted for separately and derivatives not designated in a hedging relationship but that are economic hedges and excludes derivatives that are designated and effective hedging instruments.

^(g) Includes trade accounts payable, accrued liabilities, interest payable and certain payroll-related liabilities.

^(h) Includes a long-term payable that meets the definition of a financial liability.

The Company did not elect to voluntarily designate any financial instruments as held for trading; moreover, there have not been any changes to the classification of the financial instruments since March 31, 2008.

As part of its financing transactions, the Company, through its subsidiaries, has pledged certain financial assets including cash and cash equivalents, accounts receivables, other assets and derivative assets. The aggregate carrying value of these pledged financial assets was \$67.6 million as at June 30, 2008 (\$70.7 million as at March 31, 2008).

Financial risk management

The Company is primarily exposed to credit risk, liquidity risk and market risk as a result of holding financial instruments.

Credit risk

Credit risk is defined as the Company's exposure to a financial loss if a debtor fails to meet its obligations in accordance with the terms and conditions of its arrangements with the Company, in relation to financial instruments. The Company is exposed to credit risk on its account receivables and certain other assets through its normal commercial activities. The Company is also exposed to credit risk through its normal treasury activities on its cash and cash equivalents, and derivative financial instrument assets.

Credit risks arising from the Company's normal commercial activities are independently managed and controlled by its four segments, specifically in regards to customer credit risk. Trade accounts receivable are recognized initially at fair value and subsequently measured at amortized cost less allowance for doubtful accounts. An allowance for doubtful accounts is established when there is a reasonable expectation that the Company will not be able to collect all amounts due according to the original terms of the receivables (see note 6). The carrying amount of the trade accounts receivable is reduced through the use of the allowance account and the amount of any increase to the allowance is recognized in the consolidated statement of earnings. When a trade receivable is uncollectible, it is written-off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written-off are recognized in the consolidated statement of earnings.

The Company's customers are primarily established companies with publicly available credit ratings and government agencies, which facilitates risk monitoring. In addition, the Company typically receives substantial non-refundable deposits on contracts. The Company closely monitors its exposure to major airlines in order to mitigate its risk to the extent possible. Furthermore, the Company's trade accounts receivable are not concentrated to any specific customers but rather are held from a wide range of commercial and government organizations. As well, the Company's credit exposure is further reduced by the sale of certain of its accounts receivable to a third-party for a cash consideration on a non-recourse basis. The Company does not hold any collateral as security. The credit risk on cash and cash equivalents is mitigated by the fact that they are in place with major financial institutions.

The Company is exposed to credit risk in the event of non-performance by counterparties to its derivative financial instruments. The Company minimizes this exposure by entering into contracts with counterparties that are of high credit quality. Collateral or other security to support financial instruments subject to credit risk is usually not obtained. The credit standing of counterparties is regularly monitored.

As presented in the previous financial instrument tables, the carrying amount represents the maximum exposure to credit risk for each respective financial asset as at the relevant dates. In addition, an amount of \$11.5 million (\$15.6 million as at March 31, 2008) represents the maximum exposure to credit risk for elements excluded from the previous table.

Liquidity risk

Liquidity risk is defined as the potential that the Company cannot meet a demand for cash or meet its obligations as they become due.

The Company manages this risk by establishing detailed cash forecasts, as well as long-term operating and strategic plans. The management of consolidated liquidity requires a constant monitoring of expected cash inflows and outflows which is achieved through a detailed forecast of the Company's consolidated liquidity position, to ensure adequacy and efficient use of cash resources. Liquidity adequacy is assessed in view of seasonal needs, growth requirements and capital expenditures, and the maturity profile of indebtedness, including off-balance sheet indebtedness. The Company manages its liquidity risk to maintain sufficient liquid financial resources to fund its operations and meet its commitments and obligations in a cost-efficient manner. In managing its liquidity risk, the Company has access to revolving unsecured term credit facilities of US\$400.0 million and €100.0 million. As well, the Company has an agreement to sell certain of its accounts receivable up to \$50 million. The Company also constantly monitors any financing opportunities to optimize its capital structure and maintain appropriate financial flexibility.

The following table presents a maturity analysis, from the consolidated balance sheet date to the contractual maturity date, of the Company's financial liabilities based on expected cash flows. The amounts are the contractual undiscounted cash flows. All amounts contractually denominated in foreign currency are presented in Canadian dollar equivalent amounts using the period-end spot rate except as otherwise stated:

<i>(Unaudited)</i> as at June 30, 2008 (amounts in millions)	Carrying Amount	Contractual Cash Flows	0-12 Months	13-24 Months	25-36 Months	37-48 Months	49-60 Months	Thereafter
Accounts payable and accrued liabilities ^(a, f)	\$ 290.4	\$ 290.4	\$ 290.4	\$ -	\$ -	\$ -	\$ -	\$ -
Foreign exchange forward contracts ^(b)	(6.7)							
Outflow		581.7	463.6	94.1	18.5	4.2	1.3	-
Inflow		(588.7)	(467.5)	(95.7)	(19.6)	(4.5)	(1.4)	-
Total long-term debt ^(c)	402.2	512.0	125.8	58.9	48.1	66.2	52.2	160.8
Swap derivatives on total long-term debt ^(d)	(4.0)							
Outflow		92.5	10.3	11.2	11.6	11.5	8.2	39.7
Inflow		(95.2)	(10.7)	(11.7)	(12.0)	(11.6)	(8.4)	(40.8)
Other long-term liabilities ^(e, f)	0.5	0.5	0.2	0.2	0.1	-	-	-
	\$ 682.4	\$ 793.2	\$ 412.1	\$ 57.0	\$ 46.7	\$ 65.8	\$ 51.9	\$ 159.7

(a) Includes trade accounts payable, accrued liabilities, interest payable and certain payroll-related liabilities.

(b) Includes foreign exchange forward contracts, but excludes all embedded derivatives, either presented as derivative liabilities or derivative assets. Outflows and inflows are presented in CAD equivalent using the contractual foreign exchange forward rate.

(c) Contractual cash flows include contractual interest and principal payments related to debt obligations.

(d) Includes interest rate swaps and foreign exchange swap contracts either designated as cash flow hedges or as fair value hedges of long-term debt either presented as derivative liabilities or derivative assets.

(e) Includes certain other long-term liabilities.

(f) Excludes derivative financial liabilities which have been presented separately.

Market risk

Market risk is defined as the Company's exposure to an earnings loss or a loss to the value of its financial instruments as a result of changes in market prices, whether those changes are caused by factors specific to the individual financial instruments or its issuer, or factors affecting all similar financial instruments traded in the market. The Company is mainly exposed to foreign currency risk and interest rate risk.

Foreign currency risk

Foreign currency risk is defined as the Company's exposure to an earnings loss or a loss to the value of its financial instruments as a result in the fluctuations of foreign exchange rates. The Company is exposed to foreign currency rate variability primarily in relation to certain sale commitments, expected purchase transactions and debt denominated in a foreign currency. As well, CAE's foreign operations are essentially self-sustaining and these foreign operations' functional currencies are other than the Canadian dollar (in particular the USD, € and £). The Company's related exposure to the foreign currency exchange rates is primarily through cash and cash equivalents and other working capital elements of these foreign operations.

The segments also mitigate foreign currency risks by transacting, in their functional currency for material procurement, sale contracts and financing activities.

The Company uses foreign exchange forward contracts and foreign exchange swap agreements to manage the Company's exposure from transactions in foreign currencies and to synthetically modify the currency of exposure of certain balance sheet items. The Company applies hedge accounting for a significant portion of anticipated transactions and firm commitments denominated in foreign currencies, designated as cash flow hedges. Notably, the Company enters into foreign exchange forward contracts and foreign exchange swap agreements to reduce the risk of variability of future cash flows resulting from firm sales commitments, forecasted purchases and debt denominated in foreign currencies.

The Company's foreign currency hedging programs are typically unaffected by changes in market conditions, as related derivative financial instruments are generally held to maturity, consistent with the objective to fix currency rates on the hedged item.

The Company's exposure to foreign exchange variation of 5% of our main three currencies, which is reasonably possible, does not have a significant impact on the Company's net earnings. The pre-tax impact on the OCI is \$14.7 million.

Interest rate risk

Interest rate risk is defined as the Company's exposure to a loss on earnings or a loss to the value of its financial instruments as a result of the fluctuations in interest rates. The Company bears some interest rate fluctuation risk on its floating rate long-term debt and some fair value risk on its fixed interest long-term debt. The Company mainly manages interest rate risk by fixing project-specific floating rate debt in order to reduce cash flow variability. The Company also has a floating rate debt through unhedged bank borrowing, a specific fair value hedge and other asset-specific floating rate debt. An appropriate mix of fixed and floating interest rate debt is sought to reduce the net impact of fluctuating interest rates. Derivative financial instruments used to synthetically convert interest rate exposures are mainly on interest rate swap agreements.

The Company's interest rate hedging programs are typically unaffected by changes in market conditions, as related derivative financial instruments are generally held to maturity to ensure proper asset and liability management matching, consistent with the objective to reduce risks arising from interest rate movements. As a result, the changes in variable interest rates do not have a significant impact on the Company's consolidated net income and other comprehensive income.

NOTE 12 – OPERATING SEGMENTS AND GEOGRAPHIC INFORMATION

Results by segment

The profitability measure employed by the Company for making decisions about allocating resources to segments and assessing segment performance is earnings before other income (expense), interest, income taxes and discontinued operations (hereinafter referred to as segment operating income). The accounting principles used to prepare the information by operating segments are the same as those used to prepare the Company's Consolidated Financial Statements. Transactions between operating segments are mainly simulator transfers from the Simulation Products/Civil segment to the Training & Services/Civil segment, which are recorded at cost. The method used for the allocation of assets jointly used by operating segments and costs and liabilities jointly incurred (mostly corporate costs) between operating segments is based on the level of utilization when determinable and measurable, otherwise the allocation is made based on a proportion of each segment's cost of sales.

<i>(Unaudited)</i> three months ended June 30 <i>(amounts in millions)</i>	Simulation Products		Training & Services			Total	
	2008	2007	2008	2007	2008	2007	
Civil							
External revenue	\$ 136.6	\$ 113.0	\$ 110.2	\$ 94.8	\$ 246.8	\$ 207.8	
Segment operating income	27.4	19.7	20.7	19.6	48.1	39.3	
Depreciation and amortization							
– Property, plant and equipment	1.1	1.0	11.9	11.0	13.0	12.0	
– Intangible and other assets	0.4	0.5	1.9	2.1	2.3	2.6	
Capital expenditures	0.6	0.8	34.2	26.8	34.8	27.6	
Military							
External revenue	\$ 88.4	\$ 95.5	\$ 56.9	\$ 55.0	\$ 145.3	\$ 150.5	
Segment operating income	13.6	12.3	9.6	6.4	23.2	18.7	
Depreciation and amortization							
– Property, plant and equipment	1.4	1.4	1.3	1.2	2.7	2.6	
– Intangible and other assets	1.2	0.8	0.7	0.5	1.9	1.3	
Capital expenditures	1.2	1.3	2.4	3.8	3.6	5.1	
Total							
External revenue	\$ 225.0	\$ 208.5	\$ 167.1	\$ 149.8	\$ 392.1	\$ 358.3	
Segment operating income	41.0	32.0	30.3	26.0	71.3	58.0	
Depreciation and amortization							
– Property, plant and equipment	2.5	2.4	13.2	12.2	15.7	14.6	
– Intangible and other assets	1.6	1.3	2.6	2.6	4.2	3.9	
Capital expenditures	1.8	2.1	36.6	30.6	38.4	32.7	

Assets employed by segment

The Company uses assets employed to assess resources allocated to each segment. Assets employed include accounts receivable, inventories, prepaid expenses, property, plant and equipment, goodwill, intangible assets and other assets. Assets employed exclude cash, income tax accounts and assets of certain non-operating subsidiaries.

<i>(Unaudited)</i> <i>(amounts in millions)</i>	As at June 30 2008	As at March 31 2008
Simulation Products/Civil	\$ 230.5	\$ 208.3
Simulation Products/Military	306.8	302.8
Training & Services/Civil	1,136.7	1,067.6
Training & Services/Military	222.1	219.8
Total assets employed	\$ 1,896.1	\$ 1,798.5
Assets not included in assets employed	348.3	454.7
Total assets	\$ 2,244.4	\$ 2,253.2

Geographic information

The Company markets its products and services in over 20 countries. Sales are attributed to countries based on the location of customers.

(Unaudited)

three months ended June 30

(amounts in millions)

	2008	2007
Revenue from external customers		
Canada	\$ 23.2	\$ 32.9
United States	138.8	107.6
United Kingdom	25.2	24.4
Germany	47.3	43.4
Netherlands	17.7	32.8
Other European countries	43.1	37.9
China	17.9	18.7
United Arab Emirates	15.2	14.7
Other Asian countries	29.9	20.1
Australia	19.0	8.1
Other countries	14.8	17.7
	\$ 392.1	\$ 358.3

(Unaudited)

(amounts in millions)

	As at June 30 2008	As at March 31 2008
Property, plant and equipment, goodwill and intangible assets		
Canada	\$ 189.1	\$ 205.9
United States	316.8	297.2
South America	66.6	66.1
United Kingdom	166.8	166.3
Spain	92.9	95.4
Germany	68.1	67.2
Belgium	77.3	27.1
Netherlands	133.2	134.0
Other European countries	33.9	34.2
United Arab Emirates	64.1	63.6
Asia	66.1	54.3
Other countries	13.5	13.0
	\$ 1,288.4	\$ 1,224.3

NOTE 13 – SUBSEQUENT EVENTS

In August 2008, the Company has signed an asset purchase agreement to acquire Bell Aliant's Defence, Security and Aerospace business unit which currently operates under the xwave brand for approximately \$15.1 million. This amount does not include a potential additional consideration of \$11.0 million that is contingent on certain conditions being satisfied. This transaction is anticipated to close at the end of the year.

In July 2008, the Company increased its participation in Academia Aeronautica De Evora S.A. to 90% in a non-cash transaction.