



First quarter report 2009

Management's discussion and analysis
for the three months ended June 30, 2008

August 13, 2008

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Management's Discussion and Analysis

for the three months ended June 30, 2008

1. HIGHLIGHTS

FINANCIAL

FIRST QUARTER OF FISCAL 2009

Higher revenue over last quarter and year over year

- Consolidated revenue was \$392.1 million this quarter, \$25.5 million higher than last quarter and \$33.8 million or 9% higher than the same quarter last year.

Higher earnings, net earnings and diluted earnings per share from continuing operations year over year

- Earnings from continuing operations were \$47.0 million (or \$0.18 per share) this quarter, compared to \$47.0 million (or \$0.18 per share) last quarter, and \$38.7 million (or \$0.15 per share) in the first quarter of last year, representing an increase of \$8.3 million or 21%.

Negative free cash flow¹ at \$42.4 million

- Net cash provided by continuing operations was at negative \$28.7 million this quarter, mainly due to an investment in non-cash working capital accounts;
- Maintenance capital expenditures² and other costs were \$6.6 million this quarter, compared to \$10.2 million last quarter and \$10.0 million in the first quarter of last year;
- Cash dividends were \$7.1 million this quarter, compared to \$2.4 million last quarter and \$2.4 million in the first quarter of last year.

Capital employed³ increased by 16% or \$169.6 million this quarter

- Non-cash working capital⁴ increased by \$105.3 million this quarter, ending at negative \$32.8 million;
- Long-term assets increased by \$73.1 million resulting from investments in our network and business acquisition;
- Net debt⁵ ended at \$254.5 million.

ORDERS⁶

- The book-to-sale ratio for the quarter was 0.9x. The ratio for the last 12 months was 1.2x;
- Total order intake was \$356.9 million, compared to \$437.6 million last quarter and \$307.5 million in the first quarter of last year;
- Total backlog was \$2,847.9 million as at June 30, 2008.

Civil segments

- Training & Services/Civil was awarded \$89 million in contracts;
- Simulation Products/Civil won over \$129 million of orders including 13 full-flight simulators (FFSs).

Military segments

- Simulation Products/Military won orders for approximately \$77 million for new training systems and upgrades;
- Training & Services/Military was awarded contracts over \$61 million.

ACQUISITIONS

- Acquired Sabena Flight Academy, which offers cadet training, advanced training and aviation consulting for airlines and self-sponsored pilot candidates;
- Signed an agreement in August 2008 (after quarter-end) to acquire Bell Aliant's Defence, Security and Aerospace business unit 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;
- Signed an agreement in July 2008 (after quarter-end) to increase its participation in Academia Aeronautica De Evora S.A. to 90% in a non-cash transaction.

¹ Non-GAAP measure (see Section 7.1).

² Non-GAAP measure (see Section 7.1).

³ Non-GAAP measure (see Section 8.1).

⁴ Non-GAAP measure (see Section 8.1).

⁵ Non-GAAP measure (see Section 8.1).

⁶ Non-GAAP measure (see Section 5.2).

2. INTRODUCTION

In this report, *we, us, our, CAE* and *company* refer to CAE Inc. and its subsidiaries. Unless we have indicated otherwise:

- *This year* and *2009* mean the fiscal year ending March 31, 2009;
- *Last year, prior year* and *a year ago*, mean the fiscal year ended March 31, 2008;
- Dollar amounts are in Canadian dollars.

This report was prepared as of August 13, 2008, and includes our management's discussion and analysis (MD&A), unaudited consolidated financial statements and notes for the first quarter ended June 30, 2008. We have written it to help you understand our business, performance and financial condition for the first quarter of fiscal 2009. Except as otherwise indicated, all financial information has been reported according to Canadian generally accepted accounting principles (GAAP). All tables disclosed are based on unaudited figures.

For additional information, please refer to our consolidated financial statements for the quarter ended June 30, 2008, and our annual consolidated financial statements, which you will find in our annual report for the year ended March 31, 2008. The MD&A section of our 2008 annual report also contains more information about:

- Our vision, our strategy and key performance drivers;
- Our operations;
- Foreign exchange;
- Financial measures;
- Acquisitions, business combinations and divestitures;
- Business risk and uncertainty;
- Controls and procedures;
- The oversight role of the Audit Committee and Board of Directors.

You will find our most recent annual report and annual information form (AIF) on our website at www.cae.com, on SEDAR at www.sedar.com or on EDGAR at www.sec.gov.

ABOUT MATERIAL INFORMATION

This report includes the information we believe is material to investors after considering all circumstances, including potential market sensitivity. We consider something to be material if:

- It results in, or would reasonably be expected to result in, a significant change in the market price or value of our shares, or;
- It is quite likely that a reasonable investor would consider the information to be important in making an investment decision.

ABOUT FORWARD-LOOKING STATEMENTS

This report includes forward-looking statements about our markets, future financial performance, business strategy, plans, goals and objectives. Forward-looking statements normally contain words like *believe, expect, anticipate, intend, continue, estimate, may, will, should* and similar expressions.

We have based these statements on estimates and assumptions that we believed were reasonable when the statements were prepared. Our actual results could be substantially different because of the risks and uncertainties associated with our business, or because of events that are announced or completed after the date of this report, including mergers, acquisitions, other business combinations and divestitures. You will find more information about the risks and uncertainties associated with our business in our 2008 annual report.

We do not update or revise forward-looking information even if new information becomes available unless legislation requires us to do so. You should not place undue reliance on forward-looking statements.

3. ABOUT CAE

3.1 Who we are

CAE is a world leader in providing simulation and modelling technologies and integrated training services to the civil aviation industry and defence forces around the globe.

We design, manufacture and supply simulation equipment and provide training and services. This includes integrated modelling, simulation and training solutions for commercial airlines, business aircraft operators, aircraft manufacturers and military organizations, and a global network of training centres for pilots, and in some instances, cabin crew and maintenance workers.

Our full-flight simulators (FFSs) replicate aircraft performance in a full array of situations and environmental conditions. Sophisticated visual systems simulate hundreds of airports around the world, as well as a wide range of landing areas and flying environments. These work with motion and sound to create a realistic training environment for pilots and crews at all levels.

Founded in 1947 and headquartered in Montreal, Canada, CAE has built an excellent reputation and long-standing customer relationships based on more than 60 years of experience, strong technical capabilities, a highly trained workforce and global reach. CAE employs approximately 7,000 people at more than 75 sites and training locations in 20 countries. Approximately 90% of CAE's annual revenues come from worldwide exports and international activities.

CAE's common shares are listed on the following exchanges:

- Toronto Stock Exchange, under the symbol CAE;
- New York Stock Exchange, under the symbol CGT.

3.2 Our vision

Our vision is to be a world leader in modelling, simulation and technical training to enhance safety and to lower risk and costs in complex environments.

We are ranked number one or two in the world in most of our core businesses, but competition is intense and maintaining our technological leadership and cost effectiveness is key to continued success. We have been successful at changing the way we do business, strengthening our financial position and building a solid foundation for creating shareholder value in the future.

Our focus continues to be to position CAE for growth and to move ahead in achieving our vision.

3.3 Our operations

CAE serves two markets globally:

- The civil market includes aircraft manufacturers, major commercial airlines, regional airlines, business aircraft operators, helicopter operators, training centres and pilot provisioning;
- The military market includes original equipment manufacturers (OEMs) and defence forces worldwide.

We manage our operations and report our results in four segments, one for products and one for services, for each market. Each segment is a significant contributor to our overall results.

CIVIL MARKET

Training & Services/Civil (TS/C)

Provides business and commercial aviation training for all flight and ground personnel and all associated services

Our TS/C segment is the second largest provider of civil aviation training services in the world, and serves all sectors of the market including general aviation, regional airlines, commercial airlines and business aviation. We also offer a full range of support services, such as training centre management, simulator maintenance services, spare parts inventory management, curriculum development and consulting services. We achieved our leading position through acquisitions, joint ventures and by building new facilities. We currently have more than 130 FFSs installed in more than 20 training centres around the world. We intend to increase the number of revenue simulator equivalent units (RSEUs) in our network to maintain our position and address new market opportunities. We are developing our training network primarily to meet the long-term, steady stream of recurring training needs so that as a company, we continue to become less dependent on new aircraft deliveries to drive revenue.

Simulation Products/Civil (SP/C)

Designs, manufactures and supplies civil flight simulation, training devices and visual systems

Our SP/C segment is the world leader in civil flight simulation. We design and manufacture more civil FFSs and visual systems for major and regional carriers, third-party training centres and OEMs than any other company. We have a wealth of experience in developing simulators for new types of aircraft, including over 20 models in the past and, more recently, the Boeing 787, Boeing 747-8, Airbus A380, Bombardier Global Express, Embraer Phenom 100/300 and Dassault Falcon 7X. We also offer a full range of support services including sales of spare parts, simulator updates and simulator relocations.

Market trends and outlook

Our outlook for the civil market remains relatively positive. We are monitoring key economic factors that could impact the business. The following trends support our view:

- New and more fuel-efficient platforms and strong aircraft backlogs;
- Demand in emerging markets arising from secular growth;
- Growth in revenue per passenger kilometer;
- Growing demand for trained crew members.

New and more fuel-efficient platforms and strong aircraft backlogs

New and more fuel-efficient aircraft platforms

OEMs are introducing new platforms, which will drive worldwide demand for simulators and training services. The Boeing 787, Boeing 747-8, Airbus A350XWB, Embraer 190, Dassault Falcon 7X, Embraer Phenom 100 VLJ and 300 LJ aircraft, Eclipse 500 VLJ and the Bombardier CSeries are some recent examples.

New platforms will drive the demand for new kinds of simulators. One of our strategic priorities is to partner with manufacturers to strengthen relationships and position ourselves for future opportunities. For example, CAE has been designated as Bombardier's authorized training provider for the Global Express, Global 5000 and Global Express XRS aircraft programs. CAE has also established a joint venture with Embraer to provide comprehensive training for the new Phenom 100 VLJ and Phenom 300 LJ aircraft. It is important to note that deliveries of new model aircrafts are susceptible to delays of program launches, which in turn will affect the timing of our orders and deliveries.

Strong aircraft orders contribute to lengthy backlogs

In calendar 2007, Boeing received a total of 1,413 net orders for new aircraft and Airbus received a total of 1,341 orders. As of July 20, 2008, new aircraft orders for Boeing and Airbus were 542 and 730 respectively. While the pace of order activity will likely slowdown in calendar 2008, their record backlog levels and increased production of narrow body models are expected to help generate opportunities for our full portfolio of training products and services.

Demand in emerging markets arising from secular growth

New and emerging markets

Emerging markets such as Southeast Asia, the Indian sub-continent and the Middle East continue to experience higher air traffic and economic growth than mature markets, as well as an increasing liberalization of air policy and bilateral air agreements. We expect these markets to drive the demand for FFSs and training centres. Furthermore, CAE has been introducing new products designed specifically to address new and emerging markets, such as the CAE 5000 Series FFS and CAE True™ Environment for more realistic air traffic control environment simulation.

Growth in revenue per passenger kilometer

Steady growth in air travel

While passenger traffic growth is expected to moderate from the strong growth in calendar year 2007, we anticipate that growth in passenger traffic should continue for the foreseeable future. Passenger growth in calendar year 2007 increased by 7.4% compared to 2006 and, as of April 2008, passenger growth increased by 5.6% as compared to the same period in 2007 according to the International Air Transport Association (IATA). Possible impediments to the steady growth progression in air travel include major disruptions like regional political instability, acts of terrorism, pandemics, major economic recession or other world events. Other factors which have a limiting effect on market growth include the recent record-high fuel prices, which are negatively affecting the profitability of commercial airline operations and causing flight capacity and demand reductions in market segments most acutely affected by the price of fuel.

Growing demand for trained crew members

Worldwide demand is increasing

Growth in the civil aviation market is continuing to drive the demand for pilots, maintenance technicians and flight attendants worldwide, which is creating a shortage of qualified crew members. The shortage is even more pronounced because of aging demographics, fewer military pilots transferring to civil airlines, and low enrolment in technical schools. Emerging markets like Southeast Asia and China are experiencing this even more severely because air traffic is growing at a more rapid pace than in developed countries, and the infrastructure available to meet the current and projected demand for crew members is lacking.

This creates opportunities for pilot provisioning, our turnkey service that includes recruiting, screening, selection and training. It is also prompting us to seek out partners to develop a global pipeline for developing and supplying pilots to meet market demand.

A shortage is also surfacing on the maintenance technician side and has created an opportunity for CAE to accelerate its technical training solutions. This trend is, to a lesser degree, also affecting cabin crew, where we are also exploring new training solutions.

New pilot certification process requires simulation-based training

Simulation-based pilot certification training will begin taking on an even greater role with the new Multi-crew Pilot License (MPL) certification process developed by the International Civil Aviation Organization (ICAO) and which is expected to be approved for adoption in the near future by individual national regulatory bodies. The MPL process places more emphasis on simulation-based training to develop *ab initio* students into first officers for modern aircraft. MPL is expected to be widely adopted in emerging markets like China, India and Southeast Asia where there is the greatest requirement for a large supply of qualified pilots in the most efficient and effective manner.

Economics factors

Economic growth rates continue to be supportive of demand for air travel globally, despite the economic slowing in mature markets like the U.S. and Europe. We are, however, monitoring a number of factors which could constrain growth in the broader global market: sustained high prices of jet fuel, which has an impact on airline profitability; the possibility of a protracted economic recession in the U.S., which could impact global growth; merger of airlines leading to fleet and route rationalization; and the availability of credit resources to aircraft operators given the recent tightening of credit markets.

MILITARY MARKET

Simulation Products/Military (SP/M)

Designs, manufactures and supplies advanced military training equipment and software tools for air forces, armies and navies

Our SP/M segment is a world leader in the design and production of military flight simulation equipment. We develop simulation equipment, training systems and software tools for a variety of military aircraft, including fast jets, helicopters and maritime patrol and transport aircraft. We have designed the broadest range of military helicopter simulators in the world. Our military simulators provide high-fidelity combat environments that include interactive enemy and friendly forces, as well as weapon and sensor systems. We have delivered simulation products and training systems to the military forces of more than 35 countries, including all of the U.S. services. We have also developed more training systems for the C-130 Hercules aircraft than any other company.

Training & Services/Military (TS/M)

Supplies turnkey training services, support services, systems maintenance and modelling and simulation solutions

Our TS/M segment provides contractor logistics support, maintenance services and simulator training at over 60 sites around the world. It also provides a variety of modelling and simulation-based services.

Market trends and outlook

While we expect defence budgets around the world to continue to grow modestly, including in the United States which is the world's largest defence market, we believe that our share of that spending will increase for the following reasons:

- Demand for our type of specialized products and services is growing;
- The nature of warfare has changed.

Demand for our type of specialized products and services is growing

New aircraft platforms

One of our strategic priorities is to partner with manufacturers in the military market to strengthen relationships and position ourselves for future opportunities. Original equipment manufacturers are introducing new platforms that will drive worldwide demand for simulators and training. For example, Boeing is developing a new maritime patrol aircraft called the P-8A Poseidon, NH Industries is starting to deliver the NH90 helicopter, EADS CASA is aggressively marketing the C-295 transport aircraft worldwide, and Sikorsky is offering new models of its H-60 helicopter to armies and navies worldwide, all of which fuel the demand for new simulators and training.

Trend towards outsourcing

With finite defence budgets and resources, defence forces and governments continue to scrutinize expenditures to find ways to save money and allow active-duty personnel to focus on operational requirements. There has been a growing trend among defence forces to outsource a variety of training services and we expect this trend to continue. Governments are outsourcing training services because they can be delivered more quickly and more cost-effectively. For example, CAE is part of a consortium that is expected to begin offering NH90 training to Germany and other militaries in 2008.

Greater use of simulation

More defence forces and governments are adopting simulation in training programs because it improves realism, significantly lowers costs all the more considerable in the context of sustained high fuel prices, reduces operational demands on aircraft, and lowers risk compared to operating actual weapon system platforms. Using a simulator for training also reduces actual aircraft flying hours and allows training for situations where an actual aircraft and/or its crew and passengers would be at risk. The high operational tempo stemming from ongoing global conflicts has meant that assets are being depreciated faster than originally planned. Unlike the commercial aerospace sector, where simulation-based training is already widely proliferated, there remains significant room for the adoption of simulation within the defence sector. In addition, we are seeing an increased use of simulation throughout the defence systems lifecycle, from concept development and experimentation to training and operations.

Extension and upgrade of existing weapon system platforms

Original equipment manufacturers are extending the life of existing weapon system platforms by introducing upgrades or adding new features, which increases the demand for upgrading simulators to meet the new standards.

The nature of warfare has changed

Demand for networking

The nature of warfare has changed. Allies are cooperating and creating joint and coalition forces, which is driving the demand for joint and networked training and operations. Training devices can be networked to train different crews and allows for networked training across a range of platforms.

Growing acceptance of synthetic training for mission rehearsal

There is a growing trend among defence forces to use synthetic training to meet more of their training requirements. Synthetic environment software allows defence clients to plan sophisticated missions and carry out full mission rehearsals as a complement to traditional live training or mission preparation. Synthetic training offers militaries a cost-effective way to provide realistic training for a wide variety of scenarios while ensuring they maintain a high state of readiness. For example, over the past year we have delivered MH-47G and MH-60L combat mission simulators to the U.S. Army's 160th Special Operations Aviation Regiment that feature the CAE-developed Common Database (CDB). The CDB promises to significantly enhance rapid simulation-based mission rehearsal capabilities.

4. FOREIGN EXCHANGE

We report all dollar amounts in Canadian dollars. We value assets, liabilities and transactions that are measured in foreign currencies using various exchange rates as required by GAAP.

The tables below show the variations of the closing and average exchange rates for our three main operating currencies.

We used the foreign exchange rates below to value our assets, liabilities and backlog in Canadian dollars at the end of each of the following periods:

	June 30 2008	March 31 2008	Decrease
U.S. dollar (US\$ or USD)	1.0186	1.0279	(1%)
Euro (€)	1.6041	1.6244	(1%)
British pound (£ or GBP)	2.0276	2.0407	(1%)

We used the average foreign exchange rates below to value our revenues and expenses:

	June 30 2008	March 31 2008	Increase	June 30 2007	Increase (decrease)
U.S. dollar (US\$ or USD)	1.0106	1.0050	1%	1.1007	(8%)
Euro (€)	1.5802	1.5067	5%	1.4852	6%
British pound (£ or GBP)	1.9929	1.9880	–	2.1869	(9%)

Three areas of our business are affected by changes in foreign exchange rates:

– **Our networks of civil and military training centres**

Most of our training network revenue and costs are in local currencies. Changes in the value of local currencies relative to the Canadian dollar therefore have an impact on the network's net profitability and net investment. Under GAAP, gains or losses in the net investment in a self-sustaining subsidiary that result from changes in foreign exchange rates are deferred in the foreign currency translation adjustment (accumulated other comprehensive loss), which is part of the shareholders' equity section of the balance sheet. Any effect on the fluctuation between currencies on the net profitability has an immediate translation impact on the earnings statement and an impact on year-to-year and quarter-to-quarter comparisons.

– **Our simulation products operations outside of Canada (Germany, U.S., U.K., Australia and India)**

Most of the revenue and costs in these operations from self-sustaining subsidiaries are generated in their local currency except for some data and equipment they buy in different currencies from time to time as well as any work performed by our Canadian manufacturing operations. Changes in the value of the local currency relative to the Canadian dollar therefore have a translation impact on the operation's net profitability and net investment when expressed in Canadian dollars.

– **Our simulation products operations in Canada**

Although the net assets of our Canadian operations are not exposed to changes in the value of foreign currencies (except for receivables and payables in foreign currencies), approximately 85% of our annual revenue generated from Canada is in foreign currencies (mostly the U.S. dollar and euro), while a significant portion of our expenses are in Canadian dollars.

We generally hedge the milestone payments in sales contracts denominated in foreign currencies to protect ourselves from some of the foreign exchange exposure. Since less than 100% of our revenues are hedged, it is not possible to completely offset the effects of changing foreign currency values, leaving some residual exposure that can affect the statement of earnings.

Over the long term, our manufacturing operations in Canada are exposed to changes in the value of the Canadian dollar because we do not enter into hedges of expected future revenues until the contracts are signed.

To reduce the variability of certain U.S. denominated manufacturing costs, we currently enter into hedges on foreign currency costs incurred in our manufacturing process.

5. CONSOLIDATED RESULTS

5.1 Results of our operations – first quarter of fiscal 2009

Summary of consolidated results

<i>(amounts in millions, except per share amounts)</i>	Q1-2009	Q4-2008	Q3-2008	Q2-2008	Q1-2008
Revenue	\$ 392.1	366.6	344.8	353.9	358.3
Earnings before interest and income taxes (EBIT)	\$ 71.3	69.7	61.7	62.1	58.0
<i>As a % of revenue</i>	% 18.2	19.0	17.9	17.5	16.2
Interest expense, net	\$ 4.3	4.7	4.8	5.4	2.6
Earnings from continuing operations (before taxes)	\$ 67.0	65.0	56.9	56.7	55.4
Income tax expense	\$ 20.0	18.0	16.8	17.7	16.7
Earnings from continuing operations	\$ 47.0	47.0	40.1	39.0	38.7
Results from discontinued operations	\$ (0.9)	(11.4)	(0.6)	(0.1)	–
Net earnings	\$ 46.1	35.6	39.5	38.9	38.7
Basic EPS from continuing operations	\$ 0.18	0.19	0.16	0.15	0.15
Diluted EPS from continuing operations	\$ 0.18	0.18	0.16	0.15	0.15
Basic and diluted EPS	\$ 0.18	0.14	0.16	0.15	0.15

Revenue was 7% higher than last quarter and 9% higher year over year

Revenue was \$25.5 million higher than last quarter mainly because:

- SP/C's revenue increased by \$30.1 million, or 28%, mainly due to higher number of orders and revenue recognized on simulators that were being manufactured and near completion for which sales contracts were obtained during the quarter;
- TS/C's revenue increased by \$5.7 million, or 5%, mainly due to strong demand in our European and Middle East training centres and the addition of four RSEUs in the network, mainly resulting from the acquisition of Sabena Flight Academy;
- TS/M's revenue increased by \$2.8 million, or 5%, mainly attributed to an increased level of effort on some of our maintenance services contracts on various German military bases and an annual labor rate adjustment related to U.S. military contracts.

These increases were partially offset by the decrease in SP/M's revenue of \$13.1 million, or 13%, mainly due to lower activity on some helicopter programs, particularly the German NH90 program and some U.S. Navy programs, both of which are the result of timing related to sub-contract work.

Revenue was \$33.8 million higher than the same period last year largely because:

- SP/C's revenue increased by \$23.6 million, or 21%, due to the above-mentioned quarterly comparative reasons;
- TS/C's revenue increased by \$15.4 million, or 16%, mainly due to a strong demand in most of our training centres, nine additional RSEUs, combined with the integration into our results of the acquired companies Flightscape Inc. and Sabena Flight Academy;
- TS/M's revenue increased by \$1.9 million, or 3%, due to the above-mentioned quarterly comparative reasons.

These increases were partially offset by the decrease in SP/M's revenue of \$7.1 million, or 7%, mainly due to lower level of activity on the German NH90 program and the achievement of some significant milestones on the Eurofighter program during the first quarter of last year.

The growth of 9% over last year was achieved despite the appreciation of the Canadian dollar against the British pound and the U.S. dollar.

You will find more details in *Results by segment*.

EBIT⁷ was \$1.6 million higher than last quarter and \$13.3 million higher year over year

EBIT for this quarter was \$71.3 million, or 18.2% of revenue.

Compared to the last quarter, EBIT was up by 2%, or \$1.6 million. Increased segment operating income⁸ from the SP/C and TS/M segments were partially offset by a decrease in the TS/C and SP/M segments.

Year over year, EBIT was up by 23%, or \$13.3 million, mainly because of higher segment operating income from all four segments. Segment operating income increased by \$7.7 million for SP/C, \$3.2 million for TS/M, \$1.3 million for SP/M and \$1.1 million for TS/C.

You will find more details in *Results by segment*.

Net interest expense was similar to last quarter and \$1.7 million higher year over year

Net interest expense was higher than the same period last year because the non-recourse financing was secured at the end of the first quarter of fiscal 2008.

Effective income tax rate is 30% this quarter

Income taxes this quarter were \$20.0 million, representing an effective tax rate of 30%, compared to 28% for the last quarter and 30% for the first quarter of fiscal 2008.

The tax rate was lower in the fourth quarter of fiscal 2008 mainly because of a change in the mix of income from various jurisdictions.

Results from discontinued operations

Net loss from discontinued operations was attributed to fees incurred in the litigation by the Company for further payment following the disposal of the assets of the sawmill division of the Company's Forestry Systems.

5.2 Consolidated orders and backlog⁹

Our consolidated backlog was \$2,847.9 million at the end of this quarter. New orders of \$356.9 million were added to backlog this quarter, offset by \$392.1 million in revenue generated from backlog and a decrease of \$16.8 million mainly caused by the appreciation of the Canadian dollar against the U.S. dollar, the British pound and the euro.

Backlog down by 2% over last quarter

<i>(amounts in millions)</i>	Three months ended June 30, 2008
Backlog, beginning of period	\$ 2,899.9
+ orders	356.9
- revenue	(392.1)
+ / - adjustments (mainly FX)	(16.8)
Backlog, end of period	\$ 2,847.9

The book-to-sale ratio for the quarter was 0.9x. The ratio for the last 12 months was 1.2x.

You will find more details in *Results by segment*.

⁷ Earnings before interest and taxes (EBIT) is a non-GAAP measure that shows us how we have performed before the effects of certain financing decisions and tax structures. We track EBIT because we believe it makes it easier to compare our performance with previous periods, and with companies and industries that do not have the same capital structure or tax laws.

⁸ Segment operating income (SOI) is a non-GAAP measure and our key indicator of each segment's financial performance. This measure gives us a good indication of the profitability of each segment because it does not include the impact of any items not specifically related to the segment's performance. We calculate it by using earnings before other income (expense), interest, income taxes and discontinued operations.

⁹ Backlog is a non-GAAP measure that tells us the expected value of orders we have received but have not yet executed.

- For the SP/C, SP/M and TS/M segments, we consider an item part of our backlog when we have a legally binding commercial agreement with a client that includes enough detail about each party's obligations to form the basis for a contract or an order;
- Military contracts are usually executed over a long-term period and some of them must be renewed each year. For the SP/M and TS/M segments, we only include a contract item in backlog when the customer has authorized and received funding for it;
- For the TS/C segment, we include revenues from customers with both long-term and short-term contracts when these customers commit to paying us training fees, or when we reasonably expect them from current customers.

The book-to-sale ratio is calculated as being total orders divided by total revenue in the period.

6. RESULTS BY SEGMENT

We manage our business and report our results in four segments:

Civil segments:

- Training & Services/Civil (TS/C);
- Simulation Products/Civil (SP/C).

Military segments:

- Simulation Products/Military (SP/M);
- Training & Services/Military (TS/M).

Transactions between segments are mainly transfers of simulators from SP/C to TS/C and are recorded at cost at the consolidated level.

If we can measure a segment's use of jointly used assets, costs and liabilities (mostly corporate costs), we allocate them to the segment in that proportion. If we cannot measure a segment's use, we allocate in proportion to the segment's cost of sales.

KEY PERFORMANCE INDICATORS

Segment operating income

(amounts in millions, except operating margins)

	Q1-2009	Q4-2008	Q3-2008	Q2-2008	Q1-2008
<i>Civil segments</i>					
Training & Services/Civil	\$ 20.7	23.8	15.5	14.6	19.6
	% 18.8	22.8	16.7	16.2	20.7
Simulation Products/Civil	\$ 27.4	23.8	25.2	26.2	19.7
	% 20.1	22.3	24.3	23.3	17.4
<i>Military segments</i>					
Simulation Products/Military	\$ 13.6	14.5	11.5	13.4	12.3
	% 15.4	14.3	12.8	13.8	12.9
Training & Services/Military	\$ 9.6	7.6	9.5	7.9	6.4
	% 16.9	14.0	16.1	14.5	11.6
Total segment operating income (EBIT)	\$ 71.3	69.7	61.7	62.1	58.0

We use segment operating income to measure the profitability of our four operating segments, and to help us make decisions about allocating resources. We calculate segment operating income by using a segment's net earnings before other income, interest, income taxes and discontinued operations. This allows us to assess the profitability of a segment before the impact of elements not specifically related to its performance.

Capital employed

(amounts in millions)

	Q1-2009	Q4-2008	Q3-2008	Q2-2008	Q1-2008
<i>Civil segments</i>					
Training & Services/Civil	\$ 919.0	868.3	774.3	762.5	734.7
Simulation Products/Civil	\$ (12.5)	(81.9)	(38.7)	(26.9)	(13.0)
<i>Military segments</i>					
Simulation Products/Military	\$ 106.7	68.4	100.1	98.1	90.1
Training & Services/Military	\$ 150.5	136.5	138.4	135.8	142.4
	\$ 1,163.7	991.3	974.1	969.5	954.2

6.1 Civil segments

TRAINING & SERVICES/CIVIL

TS/C was awarded \$89.0 million in contracts this quarter:

- Signed a five-year contract with Air Transat A.T. Inc. to provide pilot training on Airbus A330 and A310 platforms;
- Signed a three-year contract with Jet Alliance for the provision of ground-school and simulator training on the GV/550;
- Signed an agreement with Air Nostrum to extend their current contract on the CRJ-200 and Dash-8 until 2014 and to provide additional training platforms;
- Signed agreements to source, recruit and train more than 600 candidate pilots over a four-year period for Jazeera Airways, Kingfisher Airlines and Wizz Air.

Expansion and new initiatives

- We acquired Sabena Flight Academy, a company specializing in ab-initio pilot training and type-rating training for airlines. The company operates in Arizona, USA and Brussels, Belgium. The acquisition is aimed at expanding our ab-initio training capability and CAE Global Academy, as well as providing new type-rating training programs in Europe;
- We expanded our 20-year authorized training provider agreement with Bombardier to include Learjet 40/40 XR and Learjet 45/45 XR aircraft for European customers. We also achieved a first operational milestone of the agreement by offering pilot and technical training on the Global Express aircraft at the CAE Burgess Hill training centre in the U.K.;
- We will provide the International Air Transport Association (IATA) a foundation for its Implementation Program for Safe Operations in Africa through the application of our Flightscape flight data analysis technology.

Financial results

(amounts in millions, except operating margins, RSEU and FFSs deployed)

		Q1-2009	Q4-2008	Q3-2008	Q2-2008	Q1-2008
Revenue	\$	110.2	104.5	92.8	90.0	94.8
Segment operating income	\$	20.7	23.8	15.5	14.6	19.6
Operating margins	%	18.8	22.8	16.7	16.2	20.7
Amortization & depreciation	\$	13.8	12.9	12.5	13.5	13.1
Capital expenditures	\$	34.2	41.6	14.1	79.3	26.8
Capital employed	\$	919.0	868.3	774.3	762.5	734.7
Backlog	\$	932.7	963.3	896.1	887.5	853.4
RSEU ¹⁰		114	110	109	106	105
FFSs deployed		132	124	123	119	117

Revenue up by 5% over last quarter and by 16% year over year

The increase over last quarter was mainly attributed to a strong demand in our European and Middle East training centres and the addition of four RSEUs in the network, mainly resulting from the acquisition of Sabena Flight Academy.

The increase year over year was mainly due to a stronger demand in most of our training centres, nine additional RSEUs, combined with the integration into our results of the acquired companies Flightscape Inc. and Sabena Flight Academy. The increase was achieved despite the appreciation of the Canadian dollar against the British pound and the U.S. dollar, partially offset by a weaker Canadian dollar against the euro.

Segment operating income was \$20.7 million (18.8% of revenue) this quarter

Segment operating income was \$20.7 million (18.8% of revenue) this quarter, compared to \$23.8 million (22.8% of revenue) in the last quarter and \$19.6 million (20.7% of revenue) in the same period last year.

Segment operating income decreased by \$3.1 million, or 13%, over last quarter. This decrease was mainly attributed to costs associated with the deployment of additional FFSs in our network. Furthermore, a gain of \$0.5 million from the disposal of one FFS was recognized last quarter.

¹⁰ Revenue simulator equivalent unit (RSEU) is a financial measure we use to show the total average number of FFSs available to generate revenue during the period. For example, in the case of a 50/50 flight training joint venture, we will report only 50% of the FFSs deployed under this joint venture as an RSEU. If a FFS is being powered down and relocated, it will not be included as an RSEU until the FFS is re-installed and available to generate revenue.

Segment operating income increased by \$1.1 million, or 6%, over the same period last year. The increase in segment operating income was affected by the above-mentioned explanations, the deployment of nine additional RSEUs and the related instructor training costs. Furthermore, we incurred instructor training costs in the quarter in preparation of the deployment of additional FFSs in the coming quarters.

Capital employed increased by \$50.7 million over last quarter

The increase over last quarter was mainly due to the integration into our capital employed of the newly-acquired company Sabena Flight Academy and as a result, investments in our training network. This was partially offset by a reduction in the non-cash working capital over last quarter.

Capital expenditures at \$34.2 million this quarter

Capital expenditures were lower this quarter than last quarter mainly due to the timing on various growth projects. The level of capital expenditures reflects our ongoing investment to expand the training network in response to increased training demands.

Backlog was at \$932.7 million at the end of the quarter

<i>(amounts in millions)</i>	Three months ended June 30, 2008	
Backlog, beginning of period	\$	963.3
+ orders		89.0
- revenue		(110.2)
+ / - adjustments (mainly FX)		(9.4)
Backlog, end of period	\$	932.7

This quarter's book-to-sale ratio was 0.8x. The ratio for the last 12 months was 1.2x.

SIMULATION PRODUCTS/CIVIL

SP/C was awarded contracts for the following 13 FFSs this quarter:

- One B777 FFS to Lufthansa Flight Training GmbH;
- One B757 FFS to Flight Training Finance;
- One Embraer 190 FFS to Swiss Aviation Training;
- Two CAE 5000 Series A320 FFSs to Zhuhai Flight Training Centre, a joint venture between China Southern Airlines and CAE;
- One CAE 5000 Series A320 FFS to Aeroflot Russian Airlines;
- One B737 FFS to Skymark Airlines of Japan;
- One A320 FFS to Ansett Aviation Training;
- One A320 FFS and one B737NG FFS to CAE Bangalore training centre, a joint venture in which CAE holds a 50% ownership;
- One Global Express FFS to Bombardier;
- One A320 FFS to British Airways;
- One EMB 170/190 FFS to Embraer.

Financial results

<i>(amounts in millions, except operating margins)</i>	Q1-2009	Q4-2008	Q3-2008	Q2-2008	Q1-2008
Revenue	\$ 136.6	106.5	103.5	112.3	113.0
Segment operating income	\$ 27.4	23.8	25.2	26.2	19.7
<i>Operating margins</i>	% 20.1	22.3	24.3	23.3	17.4
Amortization & depreciation	\$ 1.5	1.8	1.6	2.0	1.5
Capital expenditures	\$ 0.6	1.2	1.2	1.4	0.8
Capital employed	\$ (12.5)	(81.9)	(38.7)	(26.9)	(13.0)
Backlog	\$ 373.2	381.8	388.7	373.3	413.3

Revenue up by 28% over last quarter and by 21% year over year

The increase over last quarter and year over year was mainly attributed to higher number of orders and revenue recognized on simulators that were being manufactured and near completion for which sales contracts were obtained during the quarter.

Segment operating income up by 15% over last quarter and by 39% year over year

Segment operating income increased over last quarter and year over year was mainly because of the above-mentioned increase in revenue.

SP/C's operating margin was 20.1% this quarter. The increase compared to last year resulted from overall execution cost reductions. The decrease compared to last quarter mainly resulted from a less favorable program mix. In addition, our overall hedge position on sale contracts is now at rates closer to par impacting SP/C's operating margin. However, our ability to sustain continuous improvements in our development and manufacturing processes are maintaining SP/C's operating margin above 20%.

Capital employed increased by \$69.4 million over last quarter

Capital employed increased over last quarter due to higher working capital accounts, mainly due to increased inventories from long-term contracts and a higher level of accounts payable at year-end.

Backlog down by 2% over last quarter

<i>(amounts in millions)</i>	Three months ended June 30, 2008
Backlog, beginning of period	\$ 381.8
+ orders	129.7
- revenue	(136.6)
+ / - adjustments (mainly FX)	(1.7)
Backlog, end of period	\$ 373.2

This quarter's book-to-sale ratio was 1.0x. The ratio for the last 12 months was 0.9x.

6.2 Military segments**SIMULATION PRODUCTS/MILITARY**

SP/M was awarded \$76.9 million in orders this quarter, including:

- Two Hawk 128 full-mission simulators (FMSs) for the Lockheed Martin and VT Group joint venture, which will provide comprehensive training to all new U.K. military aircrew across the Royal Navy, Army and Royal Air Force;
- One MH-60R avionics maintenance trainer for the U.S. Navy;
- Updated Synthetic Environment for the Eurofighter FMS and cockpit trainer in operation by various European nations.

Financial results

<i>(amounts in millions, except operating margins)</i>		Q1-2009	Q4-2008	Q3-2008	Q2-2008	Q1-2008
Revenue	\$	88.4	101.5	89.6	97.1	95.5
Segment operating income	\$	13.6	14.5	11.5	13.4	12.3
<i>Operating margins</i>	%	15.4	14.3	12.8	13.8	12.9
Amortization & depreciation	\$	2.6	2.8	3.0	2.5	2.2
Capital expenditures	\$	1.2	2.1	1.5	2.4	1.3
Capital employed	\$	106.7	68.4	100.1	98.1	90.1
Backlog	\$	752.6	765.1	704.4	535.3	560.5

Revenue down by 13% over last quarter and by 7% year over year

The decrease over last quarter was mainly due to lower activity on some helicopter programs, particularly the German NH90 program and some U.S. Navy programs, both of which are the result of timing related to sub-contract work. The decrease was partially offset by the depreciation of the Canadian dollar against the euro and the Australian dollar during the quarter.

The decrease year over year was mainly due to the above-mentioned lower level of activity on the German NH90 program, the achievement of some significant milestones on the Eurofighter program during the first quarter of last year, combined with the negative impact of the appreciation of the Canadian dollar against the U.S. dollar and the British pound.

Segment operating income down by 6% over last quarter and up by 11% year over year

The decrease over last quarter was mainly due to the above-mentioned decrease in revenue, as well as lower funding from Technology Partnerships Canada (TPC) and Investissement Québec (IQ) to our R&D initiative, Project Phoenix.

The increase year over year was mainly due to a more favorable program mix resulting from cost savings on some specific programs, as well as higher funding from Technology Partnership Canada (TPC) and Investissement Québec (IQ) to our R&D initiative, Project Phoenix. The increase was partially offset by the above-mentioned decrease in revenue.

SP/M's operating margin was 15.4% this quarter, compared to 14.3% last quarter and 12.9% year over year.

Capital employed increased by \$38.3 million over last quarter

The increase this quarter was mainly because of higher working capital accounts, primarily due to increased inventories from long-term contracts and a higher level of accounts payable at year-end.

Backlog down by 2% over last quarter

<i>(amounts in millions)</i>	Three months ended June 30, 2008	
Backlog, beginning of period	\$	765.1
+ orders		76.9
- revenue		(88.4)
+ / - adjustments (mainly FX)		(1.0)
Backlog, end of period	\$	752.6

This quarter's book-to-sale ratio was 0.9x. The ratio for the last 12 months was 1.5x.

TRAINING & SERVICES/MILITARY

TS/M was awarded \$61.3 million in orders this quarter, including:

- A five-year extension of the management and support of Australian Defence Forces aerospace simulators contract under which CAE Australia maintains simulators of the Australian Air Force. The contract was originally awarded to CAE in 2003.

Financial results

<i>(amounts in millions, except operating margins)</i>		Q1-2009	Q4-2008	Q3-2008	Q2-2008	Q1-2008
Revenue	\$	56.9	54.1	58.9	54.5	55.0
Segment operating income	\$	9.6	7.6	9.5	7.9	6.4
<i>Operating margins</i>	%	16.9	14.0	16.1	14.5	11.6
Amortization & depreciation	\$	2.0	1.8	2.4	2.2	1.7
Capital expenditures	\$	2.4	3.4	4.3	4.3	3.8
Capital employed	\$	150.5	136.5	138.4	135.8	142.4
Backlog	\$	789.4	789.7	721.5	717.2	772.3

Revenue up by 5% over last quarter and by 3% year over year

The increase over last quarter was mainly attributable to an increased level of effort on some of our maintenance services contracts on various German military bases, an annual labor rate adjustment related to U.S. military contracts, as well as the depreciation of the Canadian dollar against the euro and the Australian dollar during the quarter.

The increase year over year was mainly a result of the above-mentioned reasons, partially offset by the negative impact from the appreciation of the Canadian dollar against the U.S. dollar and the British pound.

Segment operating income up by 26% over last quarter and by 50% year over year

The increase over last quarter and year over year was mainly due to the above-mentioned increase in revenue and because we received a dividend from a U.K.-based investment of TS/M. The dividend is a component of TS/M's recurring business, even though it is not received evenly throughout the year.

Capital employed increased by \$14.0 million over last quarter

The increase this quarter was mainly the result of higher payments made to some of our key suppliers.

Backlog stable over last quarter

<i>(amounts in millions)</i>	Three months ended June 30, 2008
Backlog, beginning of period	\$ 789.7
+ orders	61.3
- revenue	(56.9)
+ / - adjustments (mainly FX)	(4.7)
Backlog, end of period	\$ 789.4

This quarter's book-to-sale ratio was 1.1x. The ratio for the last 12 months was 1.1x.

The combined military book-to-sale ratio was 1.0x for the quarter and 1.4x on a trailing 12-month basis.

7. CONSOLIDATED CASH MOVEMENTS AND LIQUIDITY

We actively manage liquidity and regularly monitor the factors that could affect it, including:

- Cash generated from operations, including timing of milestone payments and management of working capital;
- Capital expenditure requirements;
- Scheduled repayments of long-term debt obligations, our credit capacity and expected future debt market conditions.

7.1 Consolidated cash movements

For the three-month period ending (amounts in millions)	June 30 2008	March 31 2008	June 30 2007
		Restated	Restated
Cash provided by continuing operating activities*	\$ 70.4	\$ 57.7	\$ 69.2
Changes in non-cash working capital	(99.1)	73.2	(97.9)
Net cash (used in) provided by continuing operations	\$ (28.7)	\$ 130.9	\$ (28.7)
Maintenance capital expenditures	(5.5)	(9.0)	(7.5)
Other assets	(1.1)	(1.2)	(2.5)
Cash dividends	(7.1)	(2.4)	(2.4)
Free cash flow ¹¹	\$ (42.4)	\$ 118.3	\$ (41.1)
Growth capital expenditures	(32.9)	(39.3)	(25.2)
Deferred development costs	(1.9)	(2.6)	(4.8)
Deferred pre-operating costs	(0.2)	(3.0)	(0.3)
Other cash movements, net	7.4	0.1	6.9
Business acquisitions (net of cash and cash equivalents acquired)	(38.8)	(1.1)	(38.9)
Effect of foreign exchange rate changes on cash and cash equivalents	(2.3)	12.8	(6.7)
Net (decrease) increase in cash before proceeds and repayment of long-term debt	\$ (111.1)	\$ 85.2	\$ (110.1)

* before changes in non-cash working capital

On April 1st, 2008, we adopted a change to our definition of free cash flow to exclude the growth capital expenditures, capitalized costs and its corresponding asset – specific financing (including non-recourse debt).

Free cash flow down \$160.7 million from last quarter and down \$1.3 million year over year

The decrease over last quarter was mainly attributable to net cash provided by continuing operations decreasing by \$159.6 million over last quarter, explained largely by higher investment in non-cash working capital, particularly lower accounts payable, which is common at the start of our fiscal year, as well as additional cash dividends issued this quarter. This was partially offset by lower maintenance capital expenditures and other capitalized costs.

The decrease year over year was mainly due to additional cash dividends issued this quarter, offset by lower maintenance capital expenditures and other capitalized costs.

Capital expenditures of \$38.4 million

Growth capital expenditures¹² of \$32.9 million this quarter were for the ongoing investment to expand our training network to address additional market share and in response to increased training demands in new markets. Maintenance capital expenditures¹³ were \$5.5 million this quarter.

¹¹ Free cash flow is a non-GAAP measure that tells us how much cash we have available to build the business, repay debt and meet ongoing financial obligations. We use it as an indicator of our financial strength and liquidity. We calculate it by taking the net cash generated by our continuing operating activities, subtracting maintenance capital expenditures, other assets and dividends paid. Dividends are deducted in the calculation of free cash flow because we consider them an obligation, like interest on debt, which means that amount is not available for other uses.

¹² Growth capital expenditure is a non-GAAP measure we use to calculate the investment needed to increase the current level of economic activity.

¹³ Maintenance capital expenditure is a non-GAAP measure we use to calculate the capital investment needed to sustain a current level of economic activity.

8. CONSOLIDATED FINANCIAL POSITION

8.1 Consolidated capital employed

<i>(amounts in millions)</i>	As at June 30 2008	As at March 31 2008
Use of capital:		
Non-cash working capital	\$ (32.8)	\$ (138.1)
Property, plant and equipment, net	1,081.3	1,046.8
Other long-term assets	418.6	380.0
Other long-term liabilities	(224.9)	(216.1)
Total capital employed	\$ 1,242.2	\$ 1,072.6
Source of capital:		
Net debt	\$ 254.5	\$ 124.1
Shareholders' equity	987.7	948.5
Source of capital	\$ 1,242.2	\$ 1,072.6

Capital employed¹⁴ increased 16% this quarter

The increase was mainly the result of higher non-cash working capital, higher property, plant and equipment, and higher other long-term assets partially offset by higher long-term liabilities.

Our return on capital employed¹⁵ (ROCE) was 16.9% (14.8% adjusted for operating leases) this quarter compared to 14.9% (12.4% adjusted for operating leases) for the first quarter of last year.

Non-cash working capital¹⁶ increased by \$105.3 million this quarter

The increase was mainly from higher inventories as well as a decrease in accounts payable and accrued liabilities, and deposits on contracts. The increase was partially offset by a reduction in accounts receivable and prepaid expenses.

Net property, plant and equipment up \$34.5 million since last quarter

The increase from capital expenditures combined with the assets from the newly-acquired company Sabena Flight Academy were partially offset by normal depreciation and by an impact caused by foreign exchange variation.

¹⁴ Capital employed is a non-GAAP measure we use to evaluate and monitor how much we are investing in our business. We measure it from two perspectives:
Capital used:

- For the company as a whole, we take total assets (not including cash and cash equivalents), and subtract total liabilities (not including long-term debt and its current portion);
- For each segment, we take the total assets (not including cash and cash equivalents, tax accounts and other non-operating assets), and subtract total liabilities (not including tax accounts, long-term debt and its current portion and other non-operating liabilities).

Source of capital:

- We add net debt to total shareholders' equity to understand where our capital is coming from.

¹⁵ Return on capital employed (ROCE) is a non-GAAP measure that we use to evaluate the profitability of our invested capital. We calculate this ratio over a rolling four-quarter period by taking earnings from continuing operations excluding non-recurring items and interest expenses, after tax, divided by the average capital employed. In addition, we also calculate this ratio adjusting earnings and capital employed to reflect the ordinary off-balance sheet operating leases.

¹⁶ Non-cash working capital is non-GAAP measure we use to monitor how much money we have committed in the day-to-day operation of our business. We calculate it by taking current assets (not including cash and cash equivalents or the current portion of assets held for sale) and subtracting current liabilities (not including the current portion of long-term debt or the current portion of liabilities related to assets held for sale).

Net debt¹⁷ increased by \$130.4 million this quarter

The increase was largely caused by a \$111.1 million net decrease in cash, before proceeds and repayment of long-term debt and by assumption of debt held by acquired businesses.

Change in net debt

<i>(amounts in millions)</i>	Three months ended June 30, 2008	
Net debt, beginning of period	\$	124.1
Impact of cash movements on net debt (see table in the cash movements section)		111.1
Business acquisitions and others		22.2
Effect of foreign exchange rate changes on long-term debt		(2.9)
Increase in net debt during the period	\$	130.4
Net debt, end of period	\$	254.5

9. ACQUISITION

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 a 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.

10. CHANGES IN ACCOUNTING STANDARDS

We prepare our financial statements according to Canadian GAAP as published by the Accounting Standards Board (AcSB) of the Canadian Institute of Chartered Accountants (CICA) in its Handbook Sections, Accounting Guidelines (AcG) and Emerging Issues Committee.

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 of our consolidated financial statements for the first quarter ended June 30, 2008.

¹⁷ Net debt is a non-GAAP measure we use to monitor how much debt we have after taking into account liquid assets such as cash and cash equivalents. We use it as an indicator of our overall financial position, and calculate it by taking our total long-term debt (debt that matures in more than one year), including the current portion, and subtracting cash and cash equivalents.

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 of our consolidated financial statements for the first quarter ended June 30, 2008.

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.

11. INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) IMPLEMENTATION

We are currently evaluating the impact and potential effect that could result from preparing our consolidated financial statements in accordance with IFRS given that the Canadian Accounting Standards Board confirmed that IFRS will replace current Canadian standards and interpretations as Canadian generally accepted accounting principles for publicly accountable enterprises. The adoption of IFRS will have an impact on our reported consolidated financial statements as well as on a wide range of operational and internal performance measures for fiscal 2012.

As of June 30, 2008, we dedicated a team who performed a high-level accounting diagnostic and identified differences between IFRS and accounting policies and procedures currently adopted by CAE. The Company is currently evaluating the impact of adopting IFRS 1, *First-time Adoption of International Financial Reporting Standards*, elections. Furthermore, we are in the process of finalizing the design and planning phase of the IFRS implementation to identify possible accounting, information system and business solutions for the long-term implementation plan. We commenced IFRS training for our senior finance personnel to inform them of the impact on CAE's current reporting standards.

We will continue to make regular disclosure regarding the status of our implementation plan.

12. 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.

13. CONTROLS AND PROCEDURES**13.1 Evaluation of disclosure controls and procedures**

In the quarter ended June 30, 2008, the Company did not make any significant changes in, nor take any significant corrective actions regarding its internal controls or other factors that could significantly affect such internal controls. The Company's CEO and CFO periodically review the Company's disclosure controls and procedures for effectiveness and conduct an evaluation each quarter. As of the end of the first quarter, the Company's CEO and CFO were satisfied with the effectiveness of the Company's disclosure controls and procedures.