

# Management's Discussion and Analysis

for the nine months ended December 31, 2008

## 1. HIGHLIGHTS

### FINANCIAL

#### THIRD QUARTER OF FISCAL 2009

##### Higher revenue over last quarter and year over year

- Consolidated revenue was \$424.6 million this quarter, \$17.9 million or 4% higher than last quarter and \$79.8 million or 23% higher than the same quarter last year;
- For the first nine months of fiscal 2009, consolidated revenue was \$1,223.4 million, \$166.4 million or 16% higher than the same period last year.

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

- Earnings from continuing operations were \$53.3 million (or \$0.21 per share) this quarter, compared to \$48.9 million (or \$0.19 per share) last quarter, representing an increase of \$4.4 million or 9%, and compared to \$40.1 million (or \$0.16 per share) in the third quarter of last year, representing an increase of \$13.2 million or 33%;
- For the first nine months of fiscal 2009, earnings from continuing operations were \$149.2 million (or \$0.58 per share) compared to \$117.8 million (or \$0.46 per share) for the same period last year, a \$31.4 million or 27% increase.

##### Positive free cash flow<sup>1</sup> at \$71.7 million

- Net cash provided by continuing operations was \$93.6 million this quarter, compared to a positive \$59.4 million last quarter and \$61.0 million in the third quarter of last year;
- Maintenance capital expenditures<sup>2</sup> and other assets were \$14.5 million this quarter, compared to \$8.7 million last quarter and \$8.7 million in the third quarter of last year;
- Cash dividends were \$7.4 million this quarter, compared to \$7.5 million last quarter and \$2.5 million in the third quarter of last year.

##### Capital employed<sup>3</sup> increased by \$145.6 million or 11% this quarter over last quarter

- Non-cash working capital<sup>4</sup> decreased by \$31.8 million this quarter, ending at negative \$54.3 million;
- Property, plant and equipment and other long-term assets increased by \$147.1 million and \$48.5 million respectively, primarily due to changes in foreign exchange rates;
- Other long-term liabilities increased by \$18.2 million over last quarter;
- Net debt<sup>5</sup> ended at \$265.9 million this quarter.

### ORDERS<sup>6</sup>

- The book-to-sales ratio for the quarter was 1.07x. The ratio for the last 12 months was 1.03x;
- Total order intake was \$455.4 million, compared to \$389.8 million last quarter and \$566.6 million in the third quarter of last year;
- Total backlog was \$2,942.8 million as at December 31, 2008.

#### Civil segments

- Training & Services/Civil obtained contracts expected at \$139 million;
- Simulation Products/Civil won \$133 million of orders, including 11 full-flight simulators (FFSs).

#### Military segments

- Simulation Products/Military won \$92 million of orders for new training systems and upgrades;
- Training & Services/Military won contracts valued at over \$91 million.

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<sup>1</sup> Non-GAAP measure (see Section 7.1).

<sup>2</sup> Non-GAAP measure (see Section 7.1).

<sup>3</sup> Non-GAAP measure (see Section 8.1).

<sup>4</sup> Non-GAAP measure (see Section 8.1).

<sup>5</sup> Non-GAAP measure (see Section 8.1).

<sup>6</sup> 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 February 11, 2009, and includes our management's discussion and analysis (MD&A), unaudited consolidated financial statements and notes for the third quarter ended December 31, 2008. We have written it to help you understand our business, performance and financial condition for the third 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 December 31, 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](http://www.cae.com), on SEDAR at [www.sedar.com](http://www.sedar.com) or on EDGAR at [www.sec.gov](http://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. More than 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 business is the largest independent provider of commercial aviation training services in the world and the second largest provider of business aviation training services. We are unique in that we serve all sectors of the civil aviation market including general aviation, regional airlines, commercial airlines and business aviation. We offer a full range of services, including training centre management, aircraft technician training services, simulator spare parts inventory management, curriculum development, consulting services and e-Learning solutions. We are a leader in flight sciences, using flight data analysis to enable the effective study and understanding of recorded flight data to improve airline safety, maintenance and flight operations. As well, we are offering airlines a long-term solution to pilot recruitment with CAE's pilot provisioning capability. We achieved our leading position through acquisitions, joint ventures and organic investments in new facilities. We currently have more than 130 FFSs in operation and we provide aviation training and services in more than 30 locations around the world, including aviation training centres, flight training organizations (FTOs) and third party locations. We continue to selectively increase the number of revenue simulator equivalent units (RSEUs) in our network to maintain our position, increase our market share, and address new market opportunities. We are developing our training network primarily to meet the long-term, steady stream of recurring training needs from the installed aircraft base, so that 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 a 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**

We expect demand for air travel to continue to increase over the medium to long term, but we are cautious about the short term as global markets reflect constrained economic conditions. The disruption in the global financial and credit markets, specifically the apparent shortfall in aircraft financing, and the possibility of a protracted global economic recession have the potential to further impact a number of CAE's customers.

A portion of our training services revenue comes from recurrent training that is essential to support the existing global in-service aircraft fleet which totals over 33,000 aircraft. While the segment is relatively more stable, capacity reduction from airlines and business jet operators is impacting training demand on some platforms. In the products segment, we are working from a backlog that will continue to partially support our revenue for the next year. New simulation product orders could be impacted by the level of new aircraft sales and the subsequent deliveries of aircraft. We anticipate that both aircraft sales and deliveries may decline due to challenging economic conditions in 2009.

We believe that over the medium to long term the aerospace business, and more specifically the training products and services segments, will continue to experience growth. Recognizing this is a dynamic market, we continue to monitor key economic and market factors that could impact our business and potentially change our outlook. Actual and potential reductions in production rates and aircraft order cancellations by the major OEMs are important determinants in the level of demand for certain CAE products and solutions.

The impact of the current global economic slowdown is most acute in mature markets like the U.S. and Europe. Current conditions in emerging markets have slowed materially as well from their previous robust pace, however, economic growth in these regions continues to outpace the mature markets.

Notwithstanding current economic conditions, the following trends support our medium-to-long-term view for the civil market:

- Aircraft backlogs;
- New and more fuel-efficient aircraft platforms;
- Demand in emerging markets arising from secular growth and a need for infrastructure to support air travel;
- Expected long-term growth in air travel;
- Long-term demand for trained crew members.

The recent decreases in global passenger traffic, decreases in airline capacity and higher inventories of used aircraft for sale all need to be followed for any potential longer term implications.

### ***Aircraft backlogs***

In calendar 2008, Boeing received a total of 662 net orders for new aircraft and Airbus received a total of 777 orders. While the pace of order activity slowed in calendar 2008, and with recent press reports mentioning aircraft delivery deferrals by some of their customers, their record backlog levels are expected to help generate opportunities for our full portfolio of training products and services. These two OEMs have also announced customer financing programs. In the short-term, the disruption in the credit markets could materially impact aircraft deliveries.

In the business jet segment, while the backlog reached a high level, aircraft order deferrals and cancellations have already led a number of business aircraft manufacturers to lower their production rates.

### ***New and more fuel-efficient aircraft platforms***

OEMs have announced plans to introduce, or have already introduced, 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. Deliveries of new model aircraft are susceptible to program launches delays, which in turn will affect the timing of our orders and deliveries.

### ***Demand in emerging markets arising from secular growth and a need for infrastructure to support air travel***

#### ***New and emerging markets***

Emerging markets such as Southeast Asia, the Indian sub-continent and the Middle East are expected to experience higher air traffic and economic growth over the long term than mature markets, as well as an increasing liberalization of air policy and bilateral air agreements. We expect these markets to drive the long-term 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.

### ***Expected long-term growth in air travel***

While passenger traffic growth slowed in calendar 2008 from the strong growth in calendar year 2007, we anticipate that passenger traffic will resume growth in the long term. Currently, air transport is in a highly dynamic period with challenges such as a slowing world economy and a dysfunctional credit market. Over the past 20 years, air travel grew at an average of 4.8% and we expect that over the next 20 years both passenger and cargo travel will meet or slightly exceed this growth. Possible impediments to the steady growth progression in air travel include major disruptions such as regional political instability, acts of terrorism, pandemics, a sharp and sustained increase in fuel costs, economic recessions or other major world events.

### ***Long-term demand for trained crew members***

#### ***Worldwide demand is expected to increase over the long term***

Growth in the civil aviation market has driven the demand for pilots, maintenance technicians and flight attendants worldwide, which has created a shortage of qualified crew members in some markets. The shortage is impacted by aging demographics, fewer military pilots transferring to civil airlines and low enrolment in technical schools. In emerging markets like Southeast Asia and China, long-term air traffic growth is expected to outpace the developed countries, and the infrastructure available to meet the projected demand for crew members is lacking.

This shortage 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 global shortage of maintenance technicians 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) 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 need for a large supply of qualified pilots, trained in the most efficient and effective manner.

**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 remain stable or perhaps experience modest cuts in the foreseeable future, including in the United States which is the world's largest defence market, we believe that our share of defence spending will increase for the following reasons:

- Demand for our type of specialized products and services is growing;
- High cost of operating live assets for training is leading militaries to employ more simulation;
- 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 has begun offering NH90 training to Germany and other militaries in 2009.

*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.

***High cost of operating live assets for training is leading militaries to employ more simulation***

More defence forces and governments are adopting simulation in training programs because it improves realism, significantly lowers costs which has taken on greater prominence in the context of volatile 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 system's lifecycle, from concept development and experimentation to training and operations.

### ***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 allow 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 160<sup>th</sup> 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:

	<b>December 31 2008</b>	September 30 2008	Increase (decrease)	March 31 2008	Increase (decrease)
U.S. dollar (US\$ or USD)	<b>1.22</b>	1.06	15%	1.03	18%
Euro (€)	<b>1.70</b>	1.49	14%	1.62	5%
British pound (£ or GBP)	<b>1.79</b>	1.89	(5%)	2.04	(12%)

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

	<b>December 31 2008</b>	September 30 2008	Increase (decrease)	December 31 2007	Increase (decrease)
U.S. dollar (US\$ or USD)	<b>1.21</b>	1.04	16%	0.98	23%
Euro (€)	<b>1.60</b>	1.56	3%	1.42	13%
British pound (£ or GBP)	<b>1.90</b>	1.97	(4%)	2.01	(5%)

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 of 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 bought 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 the 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 revenue is hedged, it is not possible to completely offset the effects of changing foreign currency values, which leaves some residual exposure that can affect the statement of earnings.

To reduce the variability of certain U.S. denominated manufacturing costs, we had hedges on foreign currency costs incurred in our manufacturing process that expired at the end of the second quarter. In addition, we have a hedge which secures, in Canadian dollars, the interest cost and principal repayments of a U.S. denominated debt maturing in June 2009.

During the second quarter of fiscal 2009, we began to create a portfolio of currency hedging positions intended to mitigate the risk to a portion of future revenues presented by the current high-level volatility of the Canadian dollar versus the U.S. currency. The hedges are intended to cover a portion of the revenue in order to allow an unhedged portion to match the foreign cost component of the contract. With respect to the remaining expected future revenues, our manufacturing operations in Canada remain exposed to changes in the value of the Canadian dollar.

## 5. CONSOLIDATED RESULTS

### 5.1 Results of our operations – third quarter of fiscal 2009

#### Summary of consolidated results

<i>(amounts in millions, except per share amounts)</i>	<b>Q3-2009</b>	Q2-2009	Q1-2009	Q4-2008	Q3-2008
Revenue	\$ <b>424.6</b>	406.7	392.1	366.6	344.8
Earnings before interest and income taxes (EBIT)	\$ <b>78.7</b>	75.5	71.3	69.7	61.7
<i>As a % of revenue</i>	% <b>18.5</b>	18.6	18.2	19.0	17.9
Interest expense, net	\$ <b>5.6</b>	5.2	4.3	4.7	4.8
Earnings from continuing operations (before taxes)	\$ <b>73.1</b>	70.3	67.0	65.0	56.9
Income tax expense	\$ <b>19.8</b>	21.4	20.0	18.0	16.8
Earnings from continuing operations	\$ <b>53.3</b>	48.9	47.0	47.0	40.1
Results from discontinued operations	\$ <b>–</b>	(0.2)	(0.9)	(11.4)	(0.6)
Net earnings	\$ <b>53.3</b>	48.7	46.1	35.6	39.5
Basic EPS from continuing operations	\$ <b>0.21</b>	0.19	0.18	0.19	0.16
Diluted EPS from continuing operations	\$ <b>0.21</b>	0.19	0.18	0.18	0.16
Basic and diluted EPS	\$ <b>0.21</b>	0.19	0.18	0.14	0.16

#### Revenue was 4% higher than last quarter and 23% higher year over year

Revenue was \$17.9 million higher than last quarter mainly because:

- TS/C's revenue increased by \$12.9 million, or 12%, mainly due to a higher utilization of recently deployed assets and the weaker Canadian dollar against the U.S. dollar and the euro;
- SP/C's revenue increased by \$5.0 million, or 4%, mainly due to a higher number of orders and revenue recognized during this quarter on simulators that were being manufactured and near completion for which sales contracts were obtained in this quarter;
- Revenue for the two military segments (TS/M and SP/M) remained stable when compared to last quarter.

Revenue was \$79.8 million higher than the same period last year largely because:

- SP/M's revenue increased by \$35.9 million, or 40%, primarily due to a higher level of activity on various simulator contracts awarded in the last year and due to the positive impact of the depreciation of the Canadian dollar against the U.S. dollar and the euro;
- TS/C's revenue increased by \$28.1 million, or 30%. The increase was mainly due to the consolidation of the results of Sabena Flight Academy (acquired in June 2008) into our results, as well as the contribution of additional RSEUs to our network and the positive impact of foreign exchange;
- SP/C's revenue increased by \$15.8 million, or 15%, mainly due to a higher number of orders since the beginning of fiscal year 2009;
- TS/M's revenue remained stable when compared to the third quarter of fiscal 2008. An increased level of effort on some maintenance contracts and a positive foreign exchange impact were offset by lower training throughput on certain programs this quarter and a revenue recovery (resulting from our annual labor rate review with the Canadian government) that occurred in the third quarter of fiscal 2008.

Revenue year to date of \$1,223.4 million was \$166.4 million or 16% higher than the first nine months of fiscal 2008.

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

### **EBIT<sup>7</sup> was \$3.2 million higher than last quarter and \$17.0 million higher year over year**

EBIT for this quarter was \$78.7 million, or 18.5% of revenue, including a foreign exchange gain of \$1.9 million on the reduction of the investment in certain self-sustaining subsidiaries.

Compared to last quarter, EBIT was up by \$3.2 million, or 4%. Increased segment operating income<sup>8</sup> from the SP/M and TS/C segments was partly offset by a decrease from the SP/C and TS/M segments.

Year over year, EBIT was up by \$17.0 million, or 28%, mainly because of higher segment operating income of \$14.2 million for SP/M and \$6.1 million for TS/C. The increase was partially offset by a decrease of \$2.4 million for the SP/C segment and \$0.9 million for the TS/M segment.

For the first nine months of the year, EBIT was \$225.5 million, which is \$43.7 million or 24% higher than EBIT for the same period last year.

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

### **Net interest expense was higher than last quarter and year over year**

Net interest expense was higher than last quarter because of higher interest on long-term debt resulting from increased utilization of the revolving credit facility for working capital purposes.

For the first nine months of the year, the net interest expense was \$15.1 million, which is \$2.3 million higher than the same period last year. This was mainly because of higher interest expense on long-term debt attributed to higher debt levels, offset by higher capitalized interest on assets under construction.

### **Effective income tax rate is 27% this quarter**

Income taxes this quarter were \$19.8 million, representing an effective tax rate of 27%, compared to 30% last quarter and 30% for the third quarter of fiscal 2008. Income taxes for the first nine months were \$61.2 million, representing an effective tax rate of 29%, compared to 30% for the same period last year.

The tax rate was lower this quarter and for the first nine months of fiscal 2009 mainly due to the settlement of tax audits and changes in the mix of income from various jurisdictions for tax purposes.

We expect the effective income tax rate for fiscal 2009 to be approximately 30%.

<sup>7</sup> 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.

<sup>8</sup> 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.

## Results from discontinued operations

The adjustments to current earnings from gains and/or losses related to discontinued operations were nominal this quarter.

## 5.2 Consolidated orders and backlog<sup>9</sup>

Our consolidated backlog was \$2,942.8 million at the end of this quarter. New orders of \$455.4 million were added to the backlog this quarter, offset by \$424.6 million in revenue generated from backlog. The backlog was also impacted by an increase of \$170.2 million mainly caused by the depreciation of the Canadian dollar against the U.S. dollar and the euro, partly offset by the appreciation of the Canadian dollar against the British pound.

### Backlog up by 7% over last quarter mainly due to foreign currency impact

<i>(amounts in millions)</i>	Three months ended December 31, 2008	Nine months ended December 31, 2008
Backlog, beginning of period	\$ 2,741.8	\$ 2,899.9
+ orders	455.4	1,202.1
- revenue	(424.6)	(1,223.4)
+ / - adjustments (mainly FX)	170.2	64.2
Backlog, end of period	\$ 2,942.8	\$ 2,942.8

The book-to-sales ratio for the quarter was 1.07x. The ratio for the last 12 months was 1.03x.

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

## 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.

<sup>9</sup> Backlog is a non-GAAP measure that represents 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-sales ratio is the total orders divided by total revenue in the period.

**KEY PERFORMANCE INDICATORS****Segment operating income***(amounts in millions, except operating margins)*

		Q3-2009	Q2-2009	Q1-2009	Q4-2008	Q3-2008
<i>Civil segments</i>						
Training & Services/Civil	\$	21.6	19.1	20.7	23.8	15.5
	%	17.9	17.7	18.8	22.8	16.7
Simulation Products/Civil	\$	22.8	23.4	27.4	23.8	25.2
	%	19.1	20.5	20.1	22.3	24.3
<i>Military segments</i>						
Simulation Products/Military	\$	25.7	21.6	13.6	14.5	11.5
	%	20.5	17.1	15.4	14.3	12.8
Training & Services/Military	\$	8.6	11.4	9.6	7.6	9.5
	%	14.6	19.5	16.9	14.0	16.1
Total segment operating income (EBIT)	\$	78.7	75.5	71.3	69.7	61.7

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)*

		Q3-2009	Q2-2009	Q1-2009	Q4-2008	Q3-2008
<i>Civil segments</i>						
Training & Services/Civil	\$	1,083.2	939.1	919.0	868.3	774.3
Simulation Products/Civil	\$	(39.1)	(20.9)	(12.5)	(81.9)	(38.7)
<i>Military segments</i>						
Simulation Products/Military	\$	123.8	139.2	106.7	68.4	100.1
Training & Services/Military	\$	160.9	146.6	150.5	136.5	138.4
	\$	1,328.8	1,204.0	1,163.7	991.3	974.1

**6.1 Civil segments****TRAINING & SERVICES/CIVIL**

TS/C obtained contracts expected at \$138.5 million this quarter including:

- A five-year contract with Home Depot to provide a comprehensive range of pilot, technical and cabin crew training for its Dassault Falcon aircraft;
- A three-year deal with Elite Jets for Gulfstream G450 and Hawker 850XP training at our Emirates-CAE Flight Training centre;
- A long-term alliance with Honeywell under which CAE will become the preferred provider of training services for business, commercial and military aviation for Honeywell Aerospace;
- A five-year contract with Gulf Helicopter for training on the Bell 412. The training program includes simulator training on the CAE Bell 412 full-flight simulator, enhanced classroom-based training and crew resource management (CRM);
- A three-year contract with Executive AirShare to provide wet training on a number of platforms within their fleet of aircraft;
- A two-year deal with Air America Flight Services to provide wet training for its fleet of aircraft.

**Expansion and new initiatives**

- We began operations and training at our training centre in Bangalore, India;
- Four simulators were certified as ready-for-training (RFT) in the quarter, including two Airbus simulators in our training centre in Kuala Lumpur (a partnership with AirAsia), as well as a B737NG and an A320 in our Bangalore training centre.

## Financial results

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

		Q3-2009	Q2-2009	Q1-2009	Q4-2008	Q3-2008
Revenue	\$	120.9	108.0	110.2	104.5	92.8
Segment operating income	\$	21.6	19.1	20.7	23.8	15.5
Operating margins	%	17.9	17.7	18.8	22.8	16.7
Amortization & depreciation	\$	18.1	15.7	13.8	12.9	12.5
Capital expenditures	\$	39.7	42.3	34.2	41.6	14.1
Capital employed	\$	1,083.2	939.1	919.0	868.3	774.3
Backlog	\$	1,036.0	907.6	932.7	963.3	896.1
RSEU <sup>10</sup>		118	118	114	110	109
FFSs deployed		135	133	132	124	123

### Revenue up by 12% over last quarter and up 30% year over year

The increase over last quarter was attributed to a higher utilization rate, mainly on recently deployed assets, and to the weaker Canadian dollar against the U.S. dollar and the euro.

The increase year over year was mainly due to the integration of the results of Sabena Flight Academy, acquired in June 2008, combined with the contribution of additional RSEUs to our network and the positive impact of the weaker Canadian dollar against the U.S. dollar and the euro.

Revenue year to date is \$339.1 million, 22% or \$61.5 million higher than the same period last year.

### Segment operating income up 13% over last quarter and up 39% year over year

Segment operating income was \$21.6 million (17.9% of revenue) this quarter, compared to \$19.1 million (17.7% of revenue) in the last quarter and \$15.5 million (16.7% of revenue) in the same period last year.

Segment operating income increased by \$2.5 million, or 13%, over last quarter and by \$6.1 million, or 39%, over the same period last year. The increase over last quarter and over the same period last year was attributed to the increase in revenue, as well as a change in revenue mix, to the weaker Canadian dollar against the U.S. dollar and the euro, and to the ramp-up of our recently deployed devices.

Segment operating income for the first nine months of the year was \$61.4 million (18.1% of revenue), 24% or \$11.7 million higher than in the same period last year.

### Capital expenditures at \$39.7 million this quarter

Capital expenditures this quarter were in support to prior commitments and slightly lower compared to last quarter. We are continuing to expand selectively the training network to address additional market share and in response to training demands in new markets.

### Capital employed increased by \$144.1 million over last quarter

The increase over last quarter was mainly due to the impact of a weaker Canadian dollar against the U.S. dollar and the euro and to capital investments in our training network. This was partially offset by a reduction in the non-cash working capital over last quarter.

### Backlog was at \$1,036.0 million at the end of the quarter

(amounts in millions)	Three months ended December 31, 2008	Nine months ended December 31, 2008
Backlog, beginning of period	\$ 907.6	\$ 963.3
+ orders	138.5	306.3
- revenue	(120.9)	(339.1)
+ / - adjustments (mainly FX)	110.8	105.5
Backlog, end of period	\$ 1,036.0	\$ 1,036.0

This quarter's book-to-sales ratio was 1.15x. The ratio for the last 12 months was 0.95x.

<sup>10</sup> 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.

**SIMULATION PRODUCTS/CIVIL**

SP/C was awarded contracts for the following 11 FFSs this quarter:

- One B777 FFS and one B787 FFS to Air New Zealand;
- One B737NG FFS to American Airlines;
- Two A320 FFSs to Saudi Arabian Airlines;
- One A330/340 FFS to Hua Ou Aviation Training Centre;
- One A320 FFS and two B737 FFSs to Air China/Shandong Airlines;
- Two B737NG FFSs to Continental Airlines.

This brings SP/C's total order intake for the year to 31 FFSs.

**Financial results**

<i>(amounts in millions, except operating margins)</i>	Q3-2009	Q2-2009	Q1-2009	Q4-2008	Q3-2008
Revenue	\$ 119.3	114.3	136.6	106.5	103.5
Segment operating income	\$ 22.8	23.4	27.4	23.8	25.2
<i>Operating margins</i>	% 19.1	20.5	20.1	22.3	24.3
Amortization & depreciation	\$ 1.6	1.6	1.5	1.8	1.6
Capital expenditures	\$ 1.9	1.4	0.6	1.2	1.2
Capital employed	\$ (39.1)	(20.9)	(12.5)	(81.9)	(38.7)
Backlog	\$ 359.5	343.4	373.2	381.8	388.7

**Revenue up by 4% over last quarter and up by 15% year over year**

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

The increase year over year was mainly attributed to a higher number of orders since the beginning of fiscal year 2009.

Revenue year to date is \$370.2 million, 13% or \$41.4 million higher than the same period last year.

**Segment operating income down by 3% over last quarter and by 10% year over year**

Segment operating income decreased from last quarter and year over year mainly due to a different program mix and the impact of foreign exchange on U.S. and euro-denominated costs, offset partially by the receipt of \$1.7 million from a customer that had been deemed uncollectible and written-off several years prior.

Segment operating income for the first nine months of the year was \$73.6 million, 4% or \$2.5 million higher than the same period last year resulting from a higher volume of business. Year-to-date operating margins are at 19.9%, compared to 21.6% for the same period last year. This was mainly due to the depreciation of the Canadian dollar against the U.S. dollar and the euro, negatively impacting our U.S. and euro-denominated costs, whilst most of our revenue hedged earlier in the year does not yet benefit from current favourable exchange rates.

**Capital employed decreased by \$18.2 million over last quarter**

Capital employed decreased over last quarter due to lower non-cash working capital accounts.

**Backlog up by 5% over last quarter**

<i>(amounts in millions)</i>	Three months ended December 31, 2008	Nine months ended December 31, 2008
Backlog, beginning of period	\$ 343.4	\$ 381.8
+ orders	133.2	346.8
- revenue	(119.3)	(370.2)
+ / - adjustments (mainly FX)	2.2	1.1
Backlog, end of period	\$ 359.5	\$ 359.5

This quarter's book-to-sales ratio was 1.12x. The ratio for the last 12 months was 0.94x.

## 6.2 Military segments

### SIMULATION PRODUCTS/MILITARY

SP/M was awarded \$92.2 million in orders this quarter, including:

- One MH-60S tactical operational flight trainer for the U.S. Navy;
- Visual upgrade to a Eurocopter EC135 simulator used in training by the German Army in its Army Flying School in Bückebug;
- One EC135 flight training device to Eurocopter to be used in training by the Polish Army;
- Contract option exercised for increasing rapid database production on the U.S. Army Synthetic Environment Core (SE Core Program).

### Financial results

(amounts in millions, except operating margins)

	Q3-2009	Q2-2009	Q1-2009	Q4-2008	Q3-2008
Revenue	\$ 125.5	126.0	88.4	101.5	89.6
Segment operating income	\$ 25.7	21.6	13.6	14.5	11.5
Operating margins	% 20.5	17.1	15.4	14.3	12.8
Amortization & depreciation	\$ 2.7	2.3	2.6	2.8	3.0
Capital expenditures	\$ 2.2	1.1	1.2	2.1	1.5
Capital employed	\$ 123.8	139.2	106.7	68.4	100.1
Backlog	\$ 714.0	705.6	752.6	765.1	704.4

### Revenue stable compared to last quarter and up 40% year over year

We maintained a high-level of activity this quarter, representing a 40% increase over the same quarter last year. The increase mainly stems from a higher activity level on various simulator contracts awarded in the last year, both for helicopters (NH90, Super Puma) and transport aircraft (C-130, KDC-10), combined with a positive impact from the depreciation of the Canadian dollar against the U.S. dollar and the euro.

The year-to-date revenue in this segment was \$339.9 million, 20% or \$57.7 million higher than the same period last year.

### Segment operating income up by 19% over last quarter and by 123% year over year

The increase over last quarter was mainly due to a utilization of funds from our government cost sharing program that has been higher than usual. The increase year over year stems from a combination of higher volume, positive impact of the depreciation of the Canadian dollar against the U.S. dollar and the euro, as well as higher utilization of funds from our Project Phoenix research and development cost sharing program.

For the first nine months of the year, segment operating income was \$60.9 million, 64% or \$23.7 million higher than the same period last year.

### Capital employed decreased by \$15.4 million over last quarter

The decrease this quarter was mainly due of lower non-cash working capital accounts partially offset by an increase in U.S.-denominated long-term assets resulting from the depreciation of the Canadian dollar against the U.S. dollar.

### Backlog up by 1% over last quarter

(amounts in millions)	Three months ended December 31, 2008	Nine months ended December 31, 2008
Backlog, beginning of period	\$ 705.6	\$ 765.1
+ orders	92.2	281.7
- revenue	(125.5)	(339.9)
+ / - adjustments (mainly FX)	41.7	7.1
Backlog, end of period	\$ 714.0	\$ 714.0

This quarter's book-to-sales ratio was 0.73x. The ratio for the last 12 months was 0.96x.

**TRAINING & SERVICES/MILITARY**

TS/M was awarded \$91.5 million in orders this quarter, including:

- Training and maintenance service contracts to support the United States Air Force's C-130 simulators at various air force bases in the U.S.;
- A five-year service contract to train the Danish Merlin pilots at our training centre in Benson, U.K.;
- Simulator maintenance and support services to the German Ministry of Defence on various types of simulators for the German Army and Air Force.

**Financial results**

(amounts in millions, except operating margins)

	Q3-2009	Q2-2009	Q1-2009	Q4-2008	Q3-2008
Revenue	\$ 58.9	58.4	56.9	54.1	58.9
Segment operating income	\$ 8.6	11.4	9.6	7.6	9.5
Operating margins	% 14.6	19.5	16.9	14.0	16.1
Amortization & depreciation	\$ 2.2	1.9	2.0	1.8	2.4
Capital expenditures	\$ 8.1	5.8	2.4	3.4	4.3
Capital employed	\$ 160.9	146.6	150.5	136.5	138.4
Backlog	\$ 833.3	785.2	789.4	789.7	721.5

**Revenue stable over last quarter and year over year**

We maintained a revenue level of nearly \$59.0 million this quarter, witnessing an increasing level of maintenance services which compensated for lower training throughput on certain programs.

Despite a revenue recovery last year resulting from our annual labour rate review with the Canadian government, we maintained a similar revenue level mainly due to an increased level of effort on some maintenance contracts. In addition, the depreciation of the Canadian dollar against the U.S. dollar and the euro compensated for lower training throughput on certain programs.

The year-to-date revenue was \$174.2 million, 3% or \$5.8 million higher than the same period last year.

**Segment operating income down by 25% over last quarter and by 9% year over year**

The decrease over last quarter was mainly due to the fact that last quarter we received a higher dividend from a U.K.-based investment of TS/M. The dividend was \$0.8 million this quarter, compared to \$1.9 million last quarter. In addition, we had a lower training throughput on certain programs. Those unfavourable variances were partially offset by a higher utilization of funds from our Project Phoenix research and development cost sharing program.

The year-over-year decrease stems from the revenue recovery last year resulting from the labour rate review with the Canadian government as stated above, as well as lower training throughput on certain programs, partially offset by the depreciation of the Canadian dollar against the U.S. dollar and the euro.

Segment operating income for the first nine months of the year was \$29.6 million, 24% or \$5.8 million higher than the same period last year.

**Capital employed increased by \$14.3 million over last quarter**

The increase this quarter was mainly the result of additional investments in our NH90 training centre in Germany and an increase in U.S.-denominated long-term assets resulting from the depreciation of the Canadian dollar against the U.S. dollar.

**Backlog up by 6% over last quarter**

<i>(amounts in millions)</i>	Three months ended December 31, 2008	Nine months ended December 31, 2008
Backlog, beginning of period	\$ 785.2	\$ 789.7
+ orders	91.5	267.3
- revenue	(58.9)	(174.2)
+ / - adjustments (mainly FX)	15.5	(49.5)
Backlog, end of period	\$ 833.3	\$ 833.3

This quarter's book-to-sales ratio was 1.55x. The ratio for the last 12 months was 1.51x.

The combined military book-to-sales ratio was 1.00x for the quarter and 1.15x 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**

<i>(amounts in millions)</i>	Three months ended			Nine months ended	
	December 31	September 30	December 31	December 31	December 31
	2008	2007	2008	2008	2007
		Restated			Restated
Cash provided by continuing operating activities*	\$ 64.6	\$ 84.7	\$ 79.3	\$ 214.3	\$ 218.9
Changes in non-cash working capital	29.0	(23.7)	(19.9)	(90.0)	(88.9)
Net cash provided by continuing operations	\$ 93.6	\$ 61.0	\$ 59.4	\$ 124.3	\$ 130.0
Maintenance capital expenditures	(13.5)	(7.8)	(7.8)	(26.8)	(74.3)
Other assets	(1.0)	(0.9)	(0.9)	(3.0)	(4.3)
Cash dividends	(7.4)	(2.5)	(7.5)	(22.0)	(7.4)
Free cash flow <sup>11</sup>	\$ 71.7	\$ 49.8	\$ 43.2	\$ 72.5	\$ 44.0
Growth capital expenditures	(38.4)	(13.3)	(42.8)	(114.1)	(66.9)
Deferred development costs	(3.3)	(4.2)	(2.2)	(7.4)	(13.9)
Deferred pre-operating costs	(1.4)	(0.5)	(0.7)	(2.3)	(0.9)
Other cash movements, net	(7.8)	(1.1)	(0.3)	(0.7)	7.9
Business acquisitions (net of cash and cash equivalents acquired)	(0.4)	-	0.1	(39.1)	(40.7)
Effect of foreign exchange rate changes on cash and cash equivalents	19.6	(0.2)	(0.5)	16.8	(12.9)
Net increase (decrease) in cash before proceeds and repayment of long-term debt	\$ 40.0	\$ 30.5	\$ (3.2)	\$ (74.3)	\$ (83.4)

\* before changes in non-cash working capital

On April 1<sup>st</sup>, 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).

<sup>11</sup> Free cash flow is a non-GAAP measure that shows 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 the amount is not available for other uses.

**Free cash flow of \$71.7 million, up \$28.5 million from last quarter and \$21.9 million year over year**

The increase over last quarter was mainly attributable to net cash provided by continuing operations increasing by \$34.2 million, explained largely by reduced investment in non-cash working capital. The increase was partially offset by higher maintenance capital expenditures.

The increase year over year was mainly due to a lower investment in non-cash working capital of \$52.7 million, offset by a decrease of \$20.1 million in cash provided by continuing operations, an increase in maintenance capital expenditures of \$5.7 million and an increase in cash dividends of \$4.9 million.

Free cash flow year to date is \$72.5 million, \$28.5 million higher than in the same period last year. This increase is mainly attributable to lower maintenance capital expenditures (in the prior year, maintenance capital expenditures included the buyback of some leased simulators that were already part of our network), partially offset by net cash provided by continuing operations, as well as additional cash dividends issued this year.

**Capital expenditures of \$51.9 million this quarter**

Growth capital expenditures<sup>12</sup> of \$38.4 million this quarter were in support of prior commitments. We are continuing to expand selectively our training network to address additional market share and in response to training demands in new markets. Maintenance capital expenditures<sup>13</sup> were \$13.5 million this quarter.

**8. CONSOLIDATED FINANCIAL POSITION****8.1 Consolidated capital employed**

<i>(amounts in millions)</i>	As at December 31 2008	As at September 30 2008	As at March 31 2008
<b>Use of capital:</b>			
Non-cash working capital	\$ (54.3)	\$ (22.5)	\$ (138.1)
Property, plant and equipment, net	1,250.7	1,103.6	1,046.8
Other long-term assets	458.3	409.8	380.0
Other long-term liabilities	(239.4)	(221.2)	(216.1)
<b>Total capital employed</b>	<b>\$ 1,415.3</b>	<b>\$ 1,269.7</b>	<b>\$ 1,072.6</b>
<b>Source of capital:</b>			
Net debt	\$ 265.9	\$ 256.5	\$ 124.1
Shareholders' equity	1,149.4	1,013.2	948.5
<b>Source of capital</b>	<b>\$ 1,415.3</b>	<b>\$ 1,269.7</b>	<b>\$ 1,072.6</b>

**Capital employed<sup>14</sup> increased 11% this quarter over last quarter**

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

Our return on capital employed<sup>15</sup> (ROCE) was 16.8% (15.1% adjusted for operating leases) this quarter compared to 16.0% (13.6% adjusted for operating leases) for the third quarter of last year.

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

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

<sup>14</sup> 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.

<sup>15</sup> 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.

**Non-cash working capital<sup>16</sup> decreased by \$31.8 million this quarter from last quarter**

The decrease was mainly due to an increase in accounts payable and accrued liabilities and in deposits on contracts. This decrease was partially offset by increases in accounts receivable and inventories.

**Net property, plant and equipment up \$147.1 million this quarter over last quarter**

The increase was mainly caused by foreign exchange variations of \$115.5 million and capital expenditures of \$51.9 million, offset by a normal depreciation of \$20.0 million.

**Other long-term assets up by \$48.5 million this quarter over last quarter**

The increase was mainly due to an increase of \$18.4 million in goodwill, of which \$15.4 million was due to foreign exchange fluctuations and an increase of \$15.9 million in other assets primarily due to an increase in the value of the long-term derivative assets.

**Net debt<sup>17</sup> increased by \$9.4 million this quarter**

The increase of \$9.4 million was primarily caused by the depreciation of the Canadian dollar against our foreign denominated debt, partially offset by a net increase in cash before proceeds and repayments of long-term debt.

**Change in net debt**

<i>(amounts in millions)</i>	Three months ended December 31, 2008	Nine months ended December 31, 2008
Net debt, beginning of period	\$ 256.5	\$ 124.1
Impact of cash movements on net debt (see table in the cash movements section)	(40.0)	74.3
Business acquisitions and others	2.8	26.5
Effect of foreign exchange rate changes on long-term debt	46.6	41.0
Increase in net debt during the period	\$ 9.4	\$ 141.8
Net debt, end of period	\$ 265.9	\$ 265.9

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.

**Shareholders' equity increased by \$136.2 million this quarter**

The increase in equity was mainly because of net earnings (\$53.3 million) and a decrease in accumulated other comprehensive loss of \$89.7 million mainly due to the depreciation of the Canadian dollar against the U.S. dollar and the euro. This was after accounting for dividends (\$7.4 million).

*Outstanding share data*

Our articles of incorporation authorize the issue of an unlimited number of common shares, and an unlimited number of preferred shares issued in series. We had a total of 254,913,995 common shares issued and outstanding as at December 31, 2008 with total share capital of \$428.8 million.

As at January 31, 2009, we had a total of 254,923,669 common shares issued and outstanding.

<sup>16</sup> Non-cash working capital is a 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).

<sup>17</sup> 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.

## 9. BUSINESS ACQUISITIONS

### **Sabena Flight Academy**

In June 2008, the Company acquired Sabena Flight Academy (Sabena) for a total cost, including acquisition costs, of \$67.2 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. The allocation of the purchase price is preliminary and is expected to be completed in the near future.

### **Academia Aeronautica de Evora S.A.**

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

### **Kestrel Technologies Pte Ltd.**

In October 2008, the Company acquired Kestrel Technologies Pte. Ltd. (Kestrel) for a total cost, including acquisition costs, of \$0.5 million settled in cash. Kestrel provides consulting and professional services, and provides simulator maintenance and technical support services. The total costs do not include a potential additional consideration of \$0.5 million that is contingent on certain conditions being satisfied which, if met, would be recorded as additional goodwill. The allocation of the purchase price is preliminary and is expected to be completed in the near future.

### **Flightscape Inc.**

During the quarter, the Company recorded an additional purchase price of \$3.0 million payable in the fourth quarter of fiscal 2009 and reduced the additional potential consideration of \$12.0 million to \$1.0 million which, if met, would be recorded as additional goodwill. The additional purchase price was recorded as goodwill.

Goodwill recognized for these transactions, which is not deductible for tax purposes, amounts to \$23.0 million. As well, customer relationship intangible assets in the amount of \$10.8 million and a trade name intangible asset in the amount of \$0.1 million have been recognized regarding these transactions. These transactions were accounted for under the purchase method and the operating results have been included in the consolidated results of the Company since the date of each respective acquisition. The net assets of these acquisitions are included in the Training & Services/Civil segment.

### **xwave**

In August 2008, the Company 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 with an additional \$11.0 million to be paid contingent upon the occurrence of certain events for a potential total purchase price of \$26.1 million. As at December 31, 2008, this transaction was not yet closed and the Company has not consolidated xwave. This transaction is subject to customary closing conditions, including certain government approvals which remain outstanding and are currently being pursued by the parties. We anticipate to close it in the first half of calendar 2009.

## 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 consolidated financial statements. The new disclosures pursuant to these new Handbook Sections are included in Note 11 of our consolidated financial statements since the first quarter of this year.

### **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 since the first quarter of this year.

### **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.

We have a team performing a high-level accounting diagnostic and identifying 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 have finalized the design and planning phase of the IFRS implementation. We are completing the identification of 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 IFRS implementation plan.

## **12. CONTROLS AND PROCEDURES**

### **12.1 Evaluation of disclosure controls and procedures**

In the third quarter ended December 31, 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 third quarter, the Company's CEO and CFO were satisfied with the effectiveness of the Company's disclosure controls and procedures.

## 13. SELECTED QUARTERLY FINANCIAL INFORMATION

<i>(unaudited – amounts in millions, except per share amounts)</i>	Q1	Q2	Q3	Q4	Year to date
<b>Fiscal 2009</b>					
Revenue	\$ 392.1	406.7	424.6	1	1,223.4
Earnings from continuing operations	\$ 47.0	48.9	53.3	1	149.2
Basic earnings per share from continuing operations	\$ 0.18	0.19	0.21	1	0.59
Diluted earnings per share from continuing operations	\$ 0.18	0.19	0.21	1	0.58
Net earnings	\$ 46.1	48.7	53.3	1	148.1
Basic earnings per share	\$ 0.18	0.19	0.21	1	0.58
Diluted earnings per share	\$ 0.18	0.19	0.21	1	0.58
Average number of shares outstanding (basic)	254.3	254.9	254.9	1	254.7
Average number of shares outstanding (diluted)	255.1	255.4	254.9 <sup>2</sup>	1	255.1
<b>Fiscal 2008</b>					
					Total
Revenue	\$ 358.3	353.9	344.8	366.6	1,423.6
Earnings from continuing operations	\$ 38.7	39.0	40.1	47.0	164.8
Basic earnings per share from continuing operations	\$ 0.15	0.15	0.16	0.19	0.65
Diluted earnings per share from continuing operations	\$ 0.15	0.15	0.16	0.18	0.65
Net earnings	\$ 38.7	38.9	39.5	35.6	152.7
Basic earnings per share	\$ 0.15	0.15	0.16	0.14	0.60
Diluted earnings per share	\$ 0.15	0.15	0.16	0.14	0.60
Average number of shares outstanding (basic)	252.4	253.5	253.8	253.9	253.4
Average number of shares outstanding (diluted)	253.8	254.9	254.8	254.9	254.6
<b>Fiscal 2007</b>					
					Total
Revenue	\$ 301.8	280.4	331.2	337.3	1,250.7
Earnings from continuing operations	\$ 33.0	31.3	29.7	35.1	129.1
Basic earnings per share from continuing operations	\$ 0.13	0.12	0.12	0.14	0.51
Diluted earnings per share from continuing operations	\$ 0.13	0.12	0.12	0.14	0.51
Net earnings	\$ 32.4	31.0	29.7	34.3	127.4
Basic earnings per share	\$ 0.13	0.12	0.12	0.14	0.51
Diluted earnings per share	\$ 0.13	0.12	0.12	0.14	0.50
Average number of shares outstanding (basic)	250.8	251.0	251.2	251.4	251.1
Average number of shares outstanding (diluted)	253.5	252.9	253.3	253.7	253.0

<sup>1</sup> Not available.

<sup>2</sup> For the three months ended December 31, 2008, the effect of stock options potentially exercisable was anti-dilutive; therefore, the basic and diluted weighted average number of shares outstanding are the same.