

# Management's Discussion and Analysis

for the six months ended September 30, 2009

## 1. HIGHLIGHTS

### FINANCIAL

#### SECOND QUARTER OF FISCAL 2010

##### Lower revenue over last quarter and year over year

- Consolidated revenue was \$364.5 million this quarter, \$18.5 million or 5% lower than last quarter and \$42.2 million or 10% lower than the same quarter last year;
- For the first six months of fiscal 2010, consolidated revenue was \$747.5 million, \$51.3 million or 6% lower than the same period last year.

##### Earnings and diluted earnings per share from continuing operations were higher than last quarter and lower year over year

- Earnings from continuing operations were \$39.1 million (or \$0.15 per share) this quarter, compared to \$27.2 million (or \$0.11 per share) last quarter, representing an increase of \$11.9 million or 44%, and compared to \$49.2 million (or \$0.19 per share) in the second quarter of last year, representing a decrease of \$10.1 million or 21%;
- For the first six months of fiscal 2010, earnings from continuing operations were \$66.3 million (or \$0.26 per share) compared to \$97.4 million (or \$0.38 per share) for the same period last year, a \$31.1 million or 32% decrease;
- A restructuring charge of \$1.1 million was booked this quarter, compared to \$27.2 million last quarter and nil in the second quarter of last year. Excluding the restructuring charge, earnings from continuing operations were \$39.9 million this quarter (or \$0.16 per share), \$46.1 million last quarter (or \$0.18 per share) and \$86.0 million (or \$0.34 per share) for the first half of fiscal 2010.

##### Free cash flow<sup>1</sup> at positive \$93.5 million

- Net cash provided by continuing operations was a positive \$116.4 million this quarter, compared to a negative \$19.9 million last quarter and a positive \$59.0 million in the second quarter of last year;
- Maintenance capital expenditures<sup>2</sup> and other asset expenditures were \$16.3 million this quarter, compared to \$9.8 million last quarter and \$9.0 million in the second quarter of last year;
- The proceeds from the disposal of property, plant and equipment amounted to \$0.9 million this quarter;
- Cash dividends were \$7.5 million this quarter, compared to \$7.6 million last quarter and \$7.5 million in the second quarter of last year.

##### Capital employed<sup>3</sup> decreased by \$103.4 million or 7% this quarter over last quarter

- Non-cash working capital<sup>4</sup> decreased by \$34.5 million this quarter, ending at negative \$15.3 million;
- Property, plant and equipment decreased by \$64.1 million;
- Net debt<sup>5</sup> ended at \$257.8 million this quarter compared to \$340.7 million last quarter.

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

- The book-to-sales ratio for the quarter was 0.79x (combined civil was 0.66x and combined military was 0.90x). The ratio for the last 12 months was 1.13x (combined civil was 0.87x and combined military was 1.41x);
- Total order intake was \$288.1 million, compared to \$342.9 million last quarter and \$389.8 million in the second quarter of last year;
- Total backlog was \$3,034.8 million as at September 30, 2009.

#### Civil segments

- Training & Services/Civil obtained contracts with an expected value of \$82.9 million;
- Simulation Products/Civil won \$26.8 million of orders, including two full-flight simulators (FFSs).

#### Military segments

- Simulation Products/Military won \$113.5 million of orders for new training systems and upgrades;
- Training & Services/Military won contracts valued at \$64.9 million.

### OTHER

- Effective April 1, 2009, we adopted CICA Handbook Section 3064, *Goodwill and Intangible Assets*. Since adopting the new standard, we expense our pre-operating costs as they are incurred. We have retroactively restated comparative prior period information. You will find more details in *Change in accounting standards*;

<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 5.3).

## Management's Discussion and Analysis

- On July 24, 2009, we, the Solidarity Fund QFL and Société générale de financement du Québec (SGF) announced the creation of a limited partnership to provide qualifying customers competitive lease financing for CAE's civil flight simulation equipment manufactured in Québec and exported around the world;
- Effective October 1, 2009, our former Executive Vice President and Chief Operating Officer, Marc Parent, succeeded Robert E. Brown as our President and CEO;
- During the quarter, we acquired Seaweed Systems Inc. (Seaweed), a leader in embedded graphics solutions for the military and aerospace market, with noted expertise in the development of safety critical graphic drivers;
- In August 2009, we institutionalized and intensified our ongoing cooperation with AgustaWestland by incorporating a joint venture named Rotorsim S.r.l.

## 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 *2010* mean the fiscal year ending March 31, 2010;
- *Last year, prior year* and *a year ago*, mean the fiscal year ended March 31, 2009;
- Dollar amounts are in Canadian dollars.

This report was prepared as of November 11, 2009, and includes our management's discussion and analysis (MD&A), unaudited consolidated financial statements and notes for the second quarter ended September 30, 2009. We have written it to help you understand our business, performance and financial condition for the second quarter of fiscal 2010. Except as otherwise indicated, all financial information has been reported in accordance with Canadian generally accepted accounting principles (GAAP). All tables disclosed are based on unaudited figures.

For additional information, please refer to our unaudited consolidated financial statements for the quarter ended September 30, 2009, and our annual consolidated financial statements, which you will find in our annual report for the year ended March 31, 2009. The MD&A section of our 2009 annual report also contains more information about:

- Our vision;
- Our strategy and value proposition;
- Our capability to execute strategy and deliver results;
- Our operations;
- Foreign exchange;
- Non-GAAP and other financial measures;
- Consolidated results;
- 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 2009 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, develop, manufacture and supply simulation tools and equipment and provide a wide range of training and other modelling and simulation-based services. This includes integrated modelling, simulation and training solutions for commercial airlines, business aircraft operators, aircraft manufacturers and military organizations. We also operate a global network of training centres serving pilots and maintenance staff.

Our main products are full-flight simulators (FFSs), which 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 more than 6,500 people at more than 90 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 CAE (previously CGT).

#### 3.2 Our vision

Our vision is for CAE to be synonymous with safety, efficiency and mission readiness. We intend to be the partner of choice for industries operating in complex and mission-critical environments, by providing the most innovative modelling and simulation-based product and service solutions to reduce risk, lower costs and help solve challenging problems. We aspire to be the most geographically accessible, most customer-focused and most dependable company of our kind.

#### 3.3 Our operations

We primarily serve two markets globally:

- The civil market includes aircraft manufacturers, major commercial airlines, regional airlines, business aircraft operators, helicopter operators, training centres, pilot provisioning and flight training organizations;
- The military market includes original equipment manufacturers (OEMs), government agencies 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 provider of commercial aviation training services in the world and the second largest provider of business aviation training services. CAE has the broadest global network of training centres and 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 operations, pilot training, 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 our pilot provisioning capability. We achieved our leading position through acquisitions, joint ventures and organic investments in new facilities. We currently have more than 140 FFSs in operation and we provide aviation training and services in more than 20 countries around the world, including aviation training centres, flight training organizations (FTOs) and third-party locations. We make selective investments to add new revenue simulator equivalent units (RSEUs) to 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 existing fleet, 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 the provision of civil flight simulation equipment. 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 and, more recently, the Bombardier C Series and Global Express, Boeing 747-8 and 787, Airbus A380, Embraer Phenom 100/300 and Dassault Falcon 7X. We also offer a full range of support services including simulator updates, maintenance services, sales of spare parts and simulator relocations.

### **Market trends and outlook**

Demand for commercial air transportation has decreased over the past year in light of the global economic recession. Air carriers continue to adjust in the current period by reducing flight capacity – most notably in North America and to a lesser, but still significant extent, in Europe. So far, these conditions have resulted in a moderate decrease in the global active fleet of commercial aircraft, which is one of the key drivers for our training business. As well, we have seen a higher proportion of existing business jets put up for sale, which competes with the supply of new aircraft. This also means fewer flight cycles and flight crews and consequently less demand for training.

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 42,000 aircraft. While the recurrent training segment is relatively more stable, capacity reduction from airlines and business jet operators is impacting training demand on some platforms. Specifically, we have seen lower training activity commensurate with airline capacity reductions and some reductions in aircraft deliveries in business aviation, resulting in lower capacity utilization and pricing pressure in general.

More recently, we have seen demand for air travel and air cargo show signs that market conditions may be stabilizing, but at depressed levels. We expect demand for air transportation to resume its long-term growth trajectory when global economic conditions conducive to growth prevail. Despite recent market setbacks, newly revised forecasts from major aircraft OEMs still point to an approximate doubling of the global aircraft fleet over the next two decades. These assumptions continue to support our underlying strategy as a global provider of aviation training services.

In the simulation products segment, we continue to work through backlog that is partially supporting our revenue this fiscal year. We are facing a challenging market environment in which new simulation product orders are lower because airline customers are more capital constrained and therefore not procuring simulators at a rate consistent with historical ratios and present aircraft deliveries. As well, we are experiencing an additional degree of pricing pressure in the current down-cycle for the sale of simulation products as a result of CAE and our competitors pursuing fewer market opportunities. These factors combined with a strong Canadian dollar are likely to result in a lower margin in our simulation products segment. We anticipate that both aircraft sales and deliveries will decline due to challenging economic conditions in fiscal 2010 and that our total FFS sales will be approximately 20 units this year.

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 of our 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, on a percentage basis, economic growth in these regions continues to outpace the typical growth rate in mature markets. We anticipate positive world GDP growth in calendar 2010.

Our training business relies mainly on the already-installed base of aircraft in operation globally and the trade of used business aircraft. These activities are driven primarily by macroeconomic activity and corporate profitability. Our training business, to a certain extent, also relies on new aircraft deliveries. In business aviation, several aerospace companies have provided more precise guidance in terms of the short-term demand for business jets and they anticipate that deliveries will bottom in calendar 2010 and slowly recover thereafter.

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;
- New international requirements for the qualification of flight simulation training devices (FSTDs).

The 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 (firm orders, less cancellations) for new aircraft and Airbus received a total of 777 orders. For the first nine months of calendar 2009, net orders for Airbus and Boeing were 123 and 70, respectively. While the pace of order activity has slowed dramatically in calendar 2009, and with media reports of aircraft delivery deferrals by a number of airlines, Boeing and Airbus are still working through lower but still record backlog levels and this may 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 difficulties in the credit markets could materially impact aircraft deliveries.

In the business jet segment, aircraft order deferrals and cancellations have 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 747-8 and 787, Airbus A350XWB, Embraer 190, Dassault Falcon 7X, Embraer Phenom 100 VLJ and 300 LJ aircraft, Mitsubishi Regional Jet and the Bombardier CSeries are some recent examples.

New platforms will drive the demand for new kinds of simulators and training programs. One of our strategic priorities is to partner with manufacturers to strengthen relationships and position ourselves for future opportunities. For example, during the first quarter of fiscal 2010, we signed contracts with Bombardier to use our modelling and simulation expertise to support the design, development and validation of the new CSeries aircraft, and we will also develop the prototype CSeries full-flight simulator. We also have a joint venture with Embraer that is beginning to provide comprehensive training for the new Phenom 100 VLJ, and we will start to provide training for the Phenom 300 LJ aircraft beginning in calendar 2010. Deliveries of new model aircraft are susceptible to program launch 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***

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.

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

Passenger traffic declined 5% in the first nine months of calendar 2009 compared to 2008. Despite recent softness in air travel, we anticipate that passenger traffic will ultimately resume growth in the long term. There have been signs in recent months that passenger traffic as well as cargo traffic have been stabilizing, albeit at the aforementioned depressed levels. Currently, air transport is in a highly dynamic period with challenges such as a slowing world economy and a challenging 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 like regional political instability, acts of terrorism, pandemics, a sharp and sustained increase in fuel costs, major prolonged 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 India and China, long-term air traffic growth is expected to outpace the growth expected in 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 us to accelerate our technical training solutions. This trend is, to a lesser degree, also affecting cabin crew, for whom 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 Multi-crew Pilot License (MPL) certification process developed by the International Civil Aviation Organization (ICAO) which may be adopted 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. If MPL is 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, it would result in increased use of simulation-based training.

***New international requirements for the qualification of flight simulation training devices***

During the summer of 2009, the International Civil Aviation Organization (ICAO) published a document related to a strategic analysis (*Manual of Criteria for the Qualification of Flight Simulation Training Devices – Volume 1, Edition 3*) intended to define flight simulation requirements for the qualification of the new seven ICAO standard FSTDs in the 190 ICAO member States.

The ICAO document was drafted by an International Working Group (IWG) composed of members of the international regulatory community, pilot representative bodies, airlines, and the training and flight simulation industry. To achieve its goals, the IWG conducted a fundamental review to establish the simulation fidelity levels required to support each of the required training tasks for each type of pilot license, qualification, rating or training type. The resulting conclusions in the ICAO document have already started to become the basis of reference for all national and international standards for a complete range of seven FSTDs.

The ICAO document states that the top-fidelity ICAO Standard FSTD (Type VII) is required to support each of the required training tasks contained in a number of crucial training to proficiency contexts including recurrent and initial training, MPL and Airline Transport Pilot License.

The ICAO document confirms and recognizes the long-term necessity of high-fidelity FSTDs for such highly critical training contexts. The qualification requirements of the ICAO Type VII simulator require a higher fidelity of simulation (including visuals, motion, sound, etc.) than today's level D simulator requirements and we believe the increased demands for more realistic and more immersive training aligns well with CAE's strengths in aviation training as a global modelling and simulation technology leader.

## **MILITARY MARKET**

We generate revenue in six interrelated areas of the defence market value chain. We provide simulation products such as full-mission simulators; we perform updates and upgrades to simulators; we provide maintenance and support services; we offer turnkey training services; we have a range of capabilities to provide simulation-based professional services for analysis, training and operational decision-making; and we have a software business called Presagis, which develops and sells commercial-off-the-shelf modelling and simulation software solutions to mid-tier markets.

Our strategy in the defence market has been to globalize and diversify our military business. We have diversified our interests across a broad range of national markets and related defence budgets to have a more resilient and predictable stream of military business. We are a leading supplier of simulation and training solutions and have a significant local presence in seven countries. Through the successful execution of our strategy, we see tangible positive results from our efforts. In fiscal 2009, we achieved a record military order intake in excess of \$1 billion. For the same period, excluding a \$329 million Canadian contract award, the average value of our top 25 orders was \$16.3 million. The strong and diverse base of business that we have developed, combined with the encouraging trends that we see in the global defence market, specifically related to our modelling and simulation niche, give us confidence that we can continue to grow for the foreseeable future.

We approach the world's defence markets by leveraging our global footprint and our in-country expertise. We have a local presence in key markets including the U.S., U.K., Canada, Germany, Australia, India and Singapore. We compete in these markets not as a foreign company, but as a multi-domestic with local operations and domestic social relevance. We believe this is an important distinction for CAE that is made possible by our regional structure. In recent years, we have developed well-established global operating processes which allow us to place a high level of decision-making autonomy within the regions. This results in greater efficiency and stronger customer relationships.

### **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, maritime patrol and tanker/transport aircraft. We also offer simulation-based solutions for land and naval forces. We have designed the broadest range of military helicopter simulators in the world, and we have also developed more training systems for the C-130 Hercules aircraft than any other company. 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 nearly 50 military operators in approximately 35 countries, including all of the U.S. services.

### **Training & Services/Military (TS/M)**

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

Our TS/M segment provides turnkey training services and training systems integration expertise to global military forces. We also provide a range of training support services such as contractor logistics support, maintenance services and simulator training at over 60 sites around the world. TS/M additionally provides a variety of modelling and simulation-based professional and defence services.

### **Market trends and outlook**

We are well positioned on a range of military platforms involving transport aircraft, aerial refuelling tankers, helicopters, lead-in fighter trainers, and maritime patrol aircraft. These aircraft segments specifically include the C-130J Hercules transport aircraft, P-8A Poseidon and P-3C Orion maritime patrol aircraft, A330 Multi-Role Tanker Transport, NH90 helicopter, M346 and Hawk lead-in fighter trainers, H-60 helicopter variants, and other aircraft that form part of the backbone of defence forces globally. Our positive outlook is supported by the expectation that these aircraft types will continue to be in demand globally. These platforms involve newer aircraft types with long program lives ahead of them and we believe this will drive opportunities for us over the next decade. Our focus in these specific market segments is an important distinction for us as a defence contractor as we believe they are vital to the maintenance of a defence force's operational capability and readiness. We believe that we have minimal exposure to platform types that may be viewed as more discretionary by the defence establishment and therefore more susceptible to defence spending constraints.

We anticipate ongoing rationalization of defence budgets globally and for overall spending to remain stable in some markets or modestly decrease in others such as the U.S., which is the world's largest defence market. We believe, however, that defence spending in the areas involving our products and services will be stable or increase as a result of:

- Explicit desire of governments and defence forces to increase the use of modelling and simulation;
- Growing demand for our specialized modelling and simulation-based products and services;
- High cost of operating live assets for training which leads to more use of simulation;
- Current nature of warfare which requires joint forces training and mission rehearsal.

We expect that approximately 10,000 new military manned aircraft will be deployed into global military fleets over the next five years and this will generate demand for approximately 300 full-mission simulators. While we do not today address all platforms and all markets, we are able to serve a good portion of this expected demand.

**Explicit desire of governments and defence forces to increase the use of modelling and simulation**

Also helping to drive our military business is the explicit desire of governments and defence forces to increase the use of modelling and simulation for analysis, training, and operational decision-making. Unlike commercial aerospace where the use of simulation is widely proliferated, the use of simulation in defence has to date been more limited. For example, the Australian government recently issued a Defence White Paper specifically calling for increased use of modelling and simulation to relieve bottlenecks in training. This echoes the sentiments expressed by other militaries globally, especially by the U.S. defence community. Simulation offers a number of advantages that address an ever-increasing global threat level and new economic constraints that are pressuring top-line defence spending. The cost savings from the use of modelling and simulation is considerable. The U.S. Air Force estimates that live training is approximately 10 times more costly than simulation-based training. The cost of fuel, detrimental environmental impacts, and significant wear and tear on weapon systems all point to the greater use of simulation and synthetic training. This type of training is critical for ensuring the readiness of global defence forces as they face new and challenging threats.

**Growing demand for our specialized modelling and simulation-based products and services***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 delivering the NH90 helicopter, EADS CASA is aggressively marketing the A330 MRTT and C-295 transport aircraft worldwide, Lockheed Martin is doubling production of the C-130 aircraft, Alenia Aermacchi is successfully marketing the M-346 advanced lead-in fighter trainer 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, and for all of which we have products at different development and production stages.

*Trend towards outsourcing of training and maintenance services*

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, we are part of a consortium that has begun offering NH90 training to Germany and other militaries in 2009. In the United States, there are several major Aircrew Training System contracts up for re-compete over the next two to three years.

*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. For example, several OEMs are offering global militaries operating C-130 aircraft a suite of avionics upgrades, which in turn leads to a requirement for major upgrades to existing C-130 training systems or potential new C-130 training systems.

**High cost of operating live assets for training which leads to more use of simulation**

More defence forces and governments are adopting simulation in training programs because it improves realism, significantly lowers costs, 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 analysis to training and operations.

**Current nature of warfare which requires joint forces training and mission rehearsal***Demand for networking*

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 two years 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.

**HEALTHCARE MARKET**

The simulation-based aviation training model is becoming universally recognized as one of the effective ways to prepare healthcare professionals to care for patients and respond to critical situations while reducing the overall risk to patients. Through partnerships with experts in the healthcare field, we are leveraging our knowledge, experience and best practices in simulation-based aviation training to work with healthcare experts to deliver innovative education, technologies and service solutions to improve the safety and efficiency of the healthcare industry. We estimate that the total global market for simulation-based healthcare training will be in excess of \$1.5 billion by 2012. Currently, our healthcare services range from providing simulation-based training solutions to managing simulation-based training centres.

#### 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>September 30 2009</b>	June 30 2009	Increase (decrease)	March 31 2009	Increase (decrease)
U.S. dollar (US\$ or USD)	<b>1.07</b>	1.16	<i>(8%)</i>	1.26	<i>(15%)</i>
Euro (€)	<b>1.57</b>	1.63	<i>(4%)</i>	1.67	<i>(6%)</i>
British pound (£ or GBP)	<b>1.72</b>	1.91	<i>(10%)</i>	1.80	<i>(4%)</i>

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

	<b>September 30 2009</b>	June 30 2009	Increase (decrease)	September 30 2008	Increase (decrease)
U.S. dollar (US\$ or USD)	<b>1.10</b>	1.17	<i>(6%)</i>	1.04	<i>6%</i>
Euro (€)	<b>1.57</b>	1.59	<i>(1%)</i>	1.56	<i>1%</i>
British pound (£ or GBP)	<b>1.80</b>	1.81	<i>(1%)</i>	1.97	<i>(9%)</i>

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

– **Our network 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 statement of earnings 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 97% 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.

We continue to hold 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 the 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

All comparative prior period information of fiscal 2009 has been retroactively restated for a change in accounting standards, which affected our accounting treatment for pre-operating costs. You will find more details in *Change in accounting standards*.

### 5.1 Results of our operations – second quarter of fiscal 2010

#### Summary of consolidated results

<i>(amounts in millions, except per share amounts)</i>	Q2-2010	Q1-2010	Q4-2009	Q3-2009	Q2-2009
Revenue	\$ 364.5	383.0	438.8	424.6	406.7
Total segment operating income	\$ 62.3	72.3	79.6	77.6	76.0
Restructuring charge	\$ (1.1)	(27.2)	–	–	–
Earnings before interest and income taxes (EBIT)	\$ 61.2	45.1	79.6	77.6	76.0
As a % of revenue	% 16.8	11.8	18.1	18.3	18.7
Interest expense, net	\$ 7.4	6.6	5.1	5.6	5.2
Earnings from continuing operations (before taxes)	\$ 53.8	38.5	74.5	72.0	70.8
Income tax expense	\$ 14.7	11.3	21.8	19.9	21.6
Earnings from continuing operations	\$ 39.1	27.2	52.7	52.1	49.2
Results from discontinued operations	\$ –	–	–	–	(0.2)
Net earnings	\$ 39.1	27.2	52.7	52.1	49.0
Basic and diluted EPS from continuing operations	\$ 0.15	0.11	0.21	0.20	0.19
Basic and diluted EPS	\$ 0.15	0.11	0.21	0.20	0.19

Comparative periods of fiscal 2009 have been restated to reflect a change in the accounting treatment for pre-operating costs.

#### Revenue was 5% lower than last quarter and 10% lower year over year

Revenue was \$18.5 million lower than last quarter mainly because:

- SP/C's revenue decreased by \$19.2 million, or 23%, mainly due to more revenue recorded in the comparative period for simulators that were partially manufactured and for which we signed sales contracts during that period, and lower production levels this quarter resulting from a decline in order intake, an extended facility shutdown in July and furlough days;
- TS/C's revenue decreased by \$11.9 million, or 10%, mainly due to market softness in Europe and North America, seasonal fluctuations and to the negative effect from the stronger Canadian dollar against the U.S. dollar;
- TS/M's revenue decreased by \$6.3 million, or 9%, mainly due to lower training revenue this quarter from our Rotorsim joint venture and a negative foreign exchange impact. Additionally, last quarter's revenue was higher due to a receipt recorded during that quarter relating to a contract amendment, in addition to positive annual labour rate adjustments related to military contracts in the U.S.;
- SP/M's revenue increased by \$18.9 million, or 16%, mainly due to a higher level of activity this quarter, most notably for our various NH90 programs, and the integration into our results of Bell Aliant's former Defence, Security and Aerospace (DSA) business unit, acquired in May 2009. The increase was partially offset by the appreciation of the Canadian dollar against the U.S. dollar.

Revenue was \$42.2 million lower than the same period last year largely because:

- SP/C's revenue decreased by \$50.4 million, or 44%, primarily due to the above-mentioned quarterly comparative reasons. The decrease was also due to the in-progress production this quarter of a simulator which was determined to be a sales-type capital lease and for which no revenue has yet been recorded. The decrease was partially offset by favourable hedging rates;
- TS/C's revenue decreased by \$5.2 million, or 5%, mainly due to market softness in North America and to a lesser extent, in Europe. The decrease was partially offset by the contribution of additional RSEUs to our network, the weaker Canadian dollar against the U.S. dollar and by higher revenue generated in the emerging markets;
- SP/M's revenue increased by \$11.4 million, or 9%, primarily due to the above-mentioned quarterly comparative reasons.

#### Revenue for the first six months of the year was 6% lower than the same period last year

Revenue year to date was \$51.3 million lower than the same period last year largely because:

- SP/C's revenue decreased by \$103.9 million, or 41%, mainly due to the above-mentioned quarterly comparative reasons. The decrease was also due to the in-progress production in the first half of fiscal 2010 of a simulator which was determined to be a sales-type capital lease and for which no revenue has yet been recorded. The decrease was partially offset by favourable hedging rates;
- SP/M's revenue increased by \$41.5 million, or 19%, mainly due to a higher level of activity this year, most notably for our various NH90 programs, the integration into our results of DSA, acquired in May 2009 and a positive foreign exchange effect;
- TS/M's revenue increased by \$11.8 million, or 10%. The increase mainly stems from higher training revenue, most notably from our NH90 joint venture HFTS in Germany, which was inaugurated in the fourth quarter of fiscal 2009.

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

**EBIT<sup>7</sup> was \$16.1 million higher than last quarter and \$14.8 million lower year over year**

EBIT for this quarter was \$61.2 million, or 16.8% of revenue. EBIT was up by \$16.1 million or 36%, compared to last quarter, and down \$14.8 million or 19% year over year. A restructuring charge of \$1.1 million was booked this quarter, compared to \$27.2 million last quarter and nil in the second quarter of last year.

Compared to last quarter, total segment operating income<sup>8</sup> decreased by \$10.0 million, or 14%. Decreased segment operating income of \$4.9 million, \$4.3 million and \$2.9 million from TS/C, SP/C and TS/M respectively, was partially offset by an increase of \$2.1 million from the SP/M segment.

Year-over-year total segment operating income decreased by \$13.7 million, or 18%. Decreased segment operating income of \$11.0 million, \$3.6 million and \$1.8 million from SP/C, TS/C and TS/M respectively, was partially offset by an increase of \$2.7 million from the SP/M segment.

For the first six months of the year, EBIT was \$106.3 million, which was \$42.3 million or 28% lower than EBIT for the same period last year. EBIT for the first six months of fiscal 2010 included a restructuring charge of \$28.3 million (nil for the first six months of fiscal 2009). Decreased segment operating income of \$21.7 million and \$4.8 million from SP/C and TS/C respectively, was partially offset by an increase of \$11.3 million from SP/M and \$1.2 million from TS/M.

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

**Net interest expense was \$0.8 million higher than last quarter and \$2.2 million higher year over year**

Net interest expense was higher than last quarter and year over year mainly because of higher interest expense on long-term debt resulting from the net increase of senior notes for \$15 million and US\$45 million by way of a private placement in the first quarter of fiscal 2010, the net increase in capital leases, as well as higher other interest expense. The year-over-year increase was also affected by a decrease in capitalized interests for assets under construction.

For the first six months of the year, the net interest expense was \$14.0 million, which is \$4.5 million higher than the same period last year. This was mainly because of the increase in senior notes and capital leases, as well as a decrease in capitalized interests for assets under construction and higher other interest expense.

**Effective income tax rate was 27% this quarter**

Income taxes this quarter were \$14.7 million, representing an effective tax rate of 27%, compared to 29% last quarter and 31% for the second quarter of fiscal 2009. Income taxes for the first six months were \$26.0 million, representing an effective tax rate of 28%, compared to 30% for the same period last year. The effective tax rates for the comparative periods have been restated to reflect the change in accounting treatment for pre-operating costs.

The tax rate was lower this quarter and for the first six months of fiscal 2010 because of changes in the mix of income in various jurisdictions for tax purposes.

We expect the effective income tax rate for fiscal 2010 to be approximately 29%.

**Results from discontinued operations**

There were no adjustments related to discontinued operations this quarter.

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<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.

## 5.2 Restructuring

On May 14, 2009, we introduced actions required to size our company to current and expected market conditions. The actions will be concentrated in two phases. The plan includes a workforce reduction of approximately 700 employees of which 600 are in Montreal, Québec and 100 in other locations worldwide. These actions will be carried out over this fiscal year. A restructuring charge of \$28.3 million, consisting mainly of severance and other related costs, including the associated pension expense was included in net earnings for the first half of fiscal 2010. The total amount to be incurred is expected to be approximately \$32 million.

The following summarizes the restructuring costs for the period ended September 30, 2009:

<i>(amounts in millions)</i>	Employee Termination Costs	Other Costs	Total
Provision as at March 31, 2009	\$ –	\$ –	\$ –
Expenses recorded during the period	20.8	6.4	27.2
Payments made	(6.5)	(3.4)	(9.9)
Foreign exchange	0.2	–	0.2
Provision as at June 30, 2009	\$ 14.5	\$ 3.0	\$ 17.5
Expenses recorded during the period	0.7	0.4	1.1
Payments made	(5.4)	(2.1)	(7.5)
Foreign exchange	(0.3)	(0.1)	(0.4)
<b>Provision as at September 30, 2009</b>	<b>\$ 9.5</b>	<b>\$ 1.2</b>	<b>\$ 10.7</b>

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

Our consolidated backlog was \$3,034.8 million at the end of this quarter. New orders of \$288.1 million were added to the backlog this quarter, offset by \$364.5 million in revenue generated from backlog and adjustments of \$167.0 million.

### Backlog down by 7% over last quarter

<i>(amounts in millions)</i>	Three months ended September 30, 2009	Six months ended September 30, 2009
Backlog, beginning of period	\$ 3,278.2	\$ 3,181.8
+ orders	288.1	631.0
- revenue	(364.5)	(747.5)
+ / - adjustments	(167.0)	(30.5)
Backlog, end of period	\$ 3,034.8	\$ 3,034.8

Adjustments include the foreign exchange impact and a downward revision of \$38.6 million made during the quarter to incorporate the impact of revised revenue expectations for contracts signed with customers, reflecting current market conditions. The six months ended September 30, 2009 additionally includes an adjustment of \$178.0 million made last quarter to reflect the inclusion of the backlog of the DSA business acquired from Bell Aliant.

The book-to-sales ratio for the quarter was 0.79x. The ratio for the last 12 months was 1.13x.

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

<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 the contract item and has 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.

## 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

<i>(amounts in millions, except operating margins)</i>	<b>Q2-2010</b>	Q1-2010	Q4-2009	Q3-2009	Q2-2009
<i>Civil segments</i>					
Training & Services/Civil	\$ <b>15.9</b>	20.8	25.1	20.4	19.5
	% <b>15.5</b>	18.1	20.7	16.9	18.1
Simulation Products/Civil	\$ <b>12.4</b>	16.7	18.5	22.8	23.4
	% <b>19.4</b>	20.1	17.2	19.1	20.5
<i>Military segments</i>					
Simulation Products/Military	\$ <b>24.3</b>	22.2	26.8	25.7	21.6
	% <b>17.7</b>	18.7	18.7	20.5	17.1
Training & Services/Military	\$ <b>9.7</b>	12.6	9.2	8.7	11.5
	% <b>16.1</b>	18.9	13.8	14.8	19.7
<b>Total segment operating income</b>	\$ <b>62.3</b>	72.3	79.6	77.6	76.0
Restructuring charge	\$ <b>(1.1)</b>	(27.2)	–	–	–
<b>EBIT</b>	\$ <b>61.2</b>	45.1	79.6	77.6	76.0

Comparative periods of fiscal 2009 have been restated to reflect a change in the accounting treatment for pre-operating costs.

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

<i>(amounts in millions)</i>	<b>Q2-2010</b>	Q1-2010	Q4-2009	Q3-2009	Q2-2009
<i>Civil segments</i>					
Training & Services/Civil	\$ <b>1,018.9</b>	1,093.2	1,151.4	1,074.5	932.2
Simulation Products/Civil	\$ <b>28.5</b>	25.6	(53.9)	(39.1)	(20.9)
<i>Military segments</i>					
Simulation Products/Military	\$ <b>167.6</b>	174.6	148.8	123.8	139.2
Training & Services/Military	\$ <b>173.9</b>	172.5	162.2	158.5	143.9
	\$ <b>1,388.9</b>	1,465.9	1,408.5	1,317.7	1,194.4

Comparative periods of fiscal 2009 have been restated to reflect a change in the accounting treatment for pre-operating costs.

## 6.1 Civil segments

### TRAINING & SERVICES/CIVIL

TS/C obtained contracts this quarter expected to generate future revenues of \$82.9 million, including:

- A ten-year agreement with Air Transat to provide dry lease training for its A310 and A330 fleet at our Montreal training centre;
- A contract to provide wet initial training to 28 CRJ200 crews from Volga Avia Express at our Madrid training centre.

### Expansion and new initiatives

- We, through our joint venture Embraer CAE Training Services (ECTS), received certification from international regulatory authorities for two Phenom 100 FFSs designed and manufactured by CAE. ECTS provides comprehensive pilot and technical training to Embraer customers of the Phenom 100 very light jet;
- We received certification at our North East Training Centre (NETC) in Morristown, New Jersey, for a CAE 5000 Series Cessna Citation CJ3 FFS.

### Financial results

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

		Q2-2010	Q1-2010	Q4-2009	Q3-2009	Q2-2009
Revenue	\$	102.8	114.7	121.4	120.9	108.0
Segment operating income	\$	15.9	20.8	25.1	20.4	19.5
Operating margins	%	15.5	18.1	20.7	16.9	18.1
Amortization & depreciation	\$	15.7	16.9	16.1	17.8	14.9
Capital expenditures	\$	18.9	23.7	52.7	39.7	42.3
Capital employed	\$	1,018.9	1,093.2	1,151.4	1,074.5	932.2
Backlog	\$	792.3	906.9	1,006.4	1,036.0	907.6
RSEU <sup>10</sup>		128	130	123	118	118
FFSs deployed*		144	142	141	135	133

\* Excludes one FFS that was sold at the end of the second quarter of fiscal 2010 and two at the end of the first quarter of fiscal 2010. Comparative periods of fiscal 2009 have been restated to reflect a change in the accounting treatment for pre-operating costs.

### Revenue down 10% from last quarter and down 5% year over year

The decrease from last quarter was mainly attributable to market softness in Europe and North America, seasonal fluctuations and to the negative effect from the stronger Canadian dollar against the U.S. dollar.

The decrease year over year was mainly due to market softness in North America and to a lesser extent, in Europe. The decrease was partially offset by the contribution of additional RSEUs to our network, the weaker Canadian dollar against the U.S. dollar and by higher revenue generated in the emerging markets.

Revenue year to date was \$217.5 million, \$0.7 million lower than the same period last year. This was mainly explained by the market softness in North America and to a lesser extent, in Europe and was offset by the contribution of additional RSEUs to our network, by the impact of a weaker Canadian dollar against the U.S. dollar and by higher revenue generated in the emerging markets.

### Segment operating income down 24% from last quarter and down 18% year over year

Segment operating income was \$15.9 million (15.5% of revenue) this quarter, compared to \$20.8 million (18.1% of revenue) last quarter and \$19.5 million (18.1% of revenue) in the same period last year.

Segment operating income decreased by \$4.9 million, or 24%, from last quarter. The decrease was mainly attributable to a higher gain on the disposal of two used FFSs in the prior quarter compared with the gain on the disposal of one used FFS in the current quarter. The decrease was also due to the market softness in Europe combined with the negative effect from the stronger Canadian dollar against the U.S. dollar. The decrease was partially offset by cost containment measures taken in the prior quarter that began to have a positive impact on income.

Segment operating income decreased by \$3.6 million, or 18%, over the same period last year. This was mainly attributable to the market softness in Europe and North America, to the one-time realization of costs savings from the integration of a venture last year and to an unfavourable foreign exchange impact arising on the translation of working capital account balances. The decrease was partially offset by the contribution of additional RSEUs to our network, an increase in segment operating income generated in the emerging markets, the realization of a gain on the disposal of one used FFS and the weaker Canadian dollar against the U.S. dollar.

<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.

## Management's Discussion and Analysis

Segment operating income for the first six months of the year was \$36.7 million (16.9% of revenue), 12% or \$4.8 million lower than the same period last year. This was mainly attributable to the market softness in North America and Europe, to an unfavourable foreign exchange impact arising on the translation of working capital account balances and to the one-time realization of cost-savings from the integration of a venture last year. The decrease was partially offset by the contribution of additional RSEUs to our network, by the gain on the disposal of three used FFSs this year, by the impact of a weaker Canadian dollar against the U.S. dollar and by the increase in segment operating income generated in the emerging markets.

### Capital expenditures at \$18.9 million this quarter

Capital expenditures this quarter were in support of prior commitments. We are continuing to selectively expand the training network to address additional market share and in response to training demands from our customers.

### Capital employed decreased by \$74.3 million over last quarter

The decrease over last quarter was mainly due to the impact of foreign exchange fluctuations and to the reduction of non-cash working capital.

### Backlog was at \$792.3 million at the end of the quarter

<i>(amounts in millions)</i>	Three months ended September 30, 2009	Six months ended September 30, 2009
Backlog, beginning of period	\$ 906.9	\$ 1,006.4
+ orders	82.9	141.6
- revenue	(102.8)	(217.5)
+ / - adjustments	(94.7)	(138.2)
Backlog, end of period	\$ 792.3	\$ 792.3

Adjustments include the foreign exchange impact and a downward revision of \$38.6 million made during the quarter to incorporate the impact of revised revenue expectations for contracts signed with customers, reflecting current market conditions.

This quarter's book-to-sales ratio was 0.81x. The ratio for the last 12 months was 0.95x.

### SIMULATION PRODUCTS/CIVIL

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

- One CAE 5000 Series B737NG to Kenya Airways;
- One CAE 5000 Series Cessna Citation CJ1 FFS to Korean Air.

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

### Financial results

<i>(amounts in millions, except operating margins)</i>	Q2-2010	Q1-2010	Q4-2009	Q3-2009	Q2-2009
Revenue	\$ 63.9	83.1	107.3	119.3	114.3
Segment operating income	\$ 12.4	16.7	18.5	22.8	23.4
Operating margins	% 19.4	20.1	17.2	19.1	20.5
Amortization & depreciation	\$ 1.7	1.5	2.1	1.6	1.6
Capital expenditures	\$ 0.5	1.3	1.7	1.9	1.4
Capital employed	\$ 28.5	25.6	(53.9)	(39.1)	(20.9)
Backlog	\$ 254.5	293.6	288.2	359.5	343.4

### Revenue down 23% from last quarter and down 44% year over year

The decrease from last quarter was mainly due to more revenue recorded in the prior quarter for simulators that were partially manufactured and for which we signed sales contracts during that quarter and to lower production levels this quarter resulting from a decline in order intake, an extended facility shutdown in July and furlough days.

The decrease year over year was mainly due to lower production levels resulting from a decline in order intake, an extended facility shutdown in July 2009 and furlough days this quarter. Additionally, there was more revenue recorded in the second quarter of fiscal 2009 for simulators that were partially manufactured and for which we signed sales contracts during that quarter. The decrease was also due to the in-progress production this quarter of a simulator which was determined to be a sales-type capital lease and for which no revenue has yet been recorded. The decrease was partially offset by favourable hedging rates.

Revenue year to date was \$147.0 million, 41% or \$103.9 million lower than the same period last year. The decrease was mainly due to lower production levels resulting from a decline in order intake, an extended facility shutdown in July 2009 and furlough days this year. Additionally, there was more revenue recorded in the first half of fiscal 2009 for simulators that were partially manufactured and for which we signed sales contracts during that year. The decrease was also due to the in-progress production in the first half of fiscal 2010 of a simulator which was determined to be a sales-type capital lease and for which no revenue has yet been recorded. The decrease was partially offset by favourable hedging rates.

**Segment operating income down 26% from last quarter and down 47% year over year**

Segment operating income was \$12.4 million (19.4% of revenue) this quarter, compared to \$16.7 million (20.1% of revenue) in the last quarter and \$23.4 million (20.5% of revenue) in the same period last year.

The decrease from last quarter was largely due to lower volume and a reduction in the utilization of funds from our research and development cost-sharing programs, partially offset by favourable hedging rates.

The decrease year over year was primarily due to lower volume and a decline in project margins resulting from challenging market conditions, partially offset by favourable hedging rates and cost containment measures taken in the prior quarter.

Segment operating income for the first six months of the year was \$29.1 million (19.8% of revenue), 43% or \$21.7 million lower than the same period last year. The decrease was primarily due to lower volume and a decline in project margins resulting from challenging market conditions, partially offset by favourable hedging rates and cost containment measures.

**Capital employed increased by \$2.9 million over last quarter**

Capital employed increased over last quarter due to a decrease in accounts payable and accrued liabilities, partially offset by a decrease in accounts receivable.

**Backlog down by 13% over last quarter**

<i>(amounts in millions)</i>	Three months ended September 30, 2009	Six months ended September 30, 2009
Backlog, beginning of period	\$ 293.6	\$ 288.2
+ orders	26.8	117.5
- revenue	(63.9)	(147.0)
+ / - adjustments (mainly FX)	(2.0)	(4.2)
Backlog, end of period	\$ 254.5	\$ 254.5

This quarter's book-to-sales ratio was 0.42x. The ratio for the last 12 months was 0.77x.

**6.2 Military segments****SIMULATION PRODUCTS/MILITARY**

SP/M was awarded \$113.5 million in orders this quarter, including:

- Major upgrades on two CAE-built CH-53 full-mission simulators (FMSs) operated at the German Army Aviation School in Bückeburg;
- Ground-based tactical mission trainers to Lockheed Martin to be used by the U.K. military;
- A330 Multi-Role Tanker Transport part-task trainers and integrated procedures trainers to be used by the United Arab Emirates (UAE) and the Royal Saudi Air Force (RSAF).

**Financial results**

<i>(amounts in millions, except operating margins)</i>	Q2-2010	Q1-2010	Q4-2009	Q3-2009	Q2-2009
Revenue	\$ 137.4	118.5	143.6	125.5	126.0
Segment operating income	\$ 24.3	22.2	26.8	25.7	21.6
Operating margins	% 17.7	18.7	18.7	20.5	17.1
Amortization & depreciation	\$ 3.2	2.6	3.8	2.7	2.3
Capital expenditures	\$ 1.1	1.5	2.0	2.2	1.1
Capital employed	\$ 167.6	174.6	148.8	123.8	139.2
Backlog	\$ 889.8	1,072.5	893.0	714.0	705.6

**Revenue up by 16% compared to last quarter and up by 9% year over year**

The increase over last quarter was mainly due to a higher level of activity this quarter, most notably for our various NH90 programs, and the integration into our results of DSA, acquired in May 2009. The increase was partially offset by the appreciation of the Canadian dollar against the U.S. dollar.

The year-over-year increase was mainly due to a higher level of activity this quarter, most notably for our various NH90 programs, and the integration into our results of DSA, acquired in May 2009.

Revenue year to date was \$255.9 million, 19% or \$41.5 million higher than the same period last year. The increase was mainly due to a higher level of activity this year, most notably for our various NH90 programs, the integration into our results of DSA, acquired in May 2009 and a positive foreign exchange effect.

**Segment operating income up by 9% over last quarter and up by 13% year over year**

Segment operating income was \$24.3 million (17.7% of revenue) this quarter, compared to \$22.2 million (18.7% of revenue) last quarter and \$21.6 million (17.1% of revenue) in the same period last year.

The increase over last quarter was mainly due to the increased volume, as explained above, partially offset by a lower utilization of funds from our research and development cost-sharing programs.

The year-over-year increase mainly stems from the increased volume, also explained above, combined with higher investment tax credits.

Segment operating income for the first six months of the year was \$46.5 million (18.2% of revenue), 32% or \$11.3 million higher than in the same period last year. The increase was mainly due to increased volume.

**Capital employed decreased by \$7.0 million over last quarter**

The decrease over last quarter was mainly due to a decrease in our non-cash working capital accounts.

**Backlog down by 17% over last quarter**

<i>(amounts in millions)</i>	Three months ended September 30, 2009	Six months ended September 30, 2009
Backlog, beginning of period	\$ 1,072.5	\$ 893.0
+ orders	113.5	242.8
- revenue	(137.4)	(255.9)
+ / - adjustments	(158.8)	9.9
Backlog, end of period	\$ 889.8	\$ 889.8

Adjustments include the foreign exchange impact and an amount of \$134.0 million transferred from SP/M's backlog to TS/M's backlog. The \$134.0 million represents certain contracts acquired in the DSA transaction that have now been identified as TS/M related. The transfer has no impact on the combined military backlog.

This quarter's book-to-sales ratio was 0.83x. The ratio for the last 12 months was 1.24x.

**TRAINING & SERVICES/MILITARY**

TS/M was awarded \$64.9 million in orders this quarter including:

- A one-year contract to continue to provide avionics software upgrades, integrated logistics support and data management services for the Canadian Forces' CF-18 aircraft;
- A three-year contract with the Royal Netherlands Navy to provide Lynx simulator maintenance and technical logistics support;
- C-130H training services for a Middle East customer.

**Financial results**

<i>(amounts in millions, except operating margins)</i>	Q2-2010	Q1-2010	Q4-2009	Q3-2009	Q2-2009
Revenue	\$ 60.4	66.7	66.5	58.9	58.4
Segment operating income	\$ 9.7	12.6	9.2	8.7	11.5
Operating margins	% 16.1	18.9	13.8	14.8	19.7
Amortization & depreciation	\$ 2.6	2.3	2.6	2.1	1.9
Capital expenditures	\$ 5.8	5.5	6.4	8.1	5.8
Capital employed	\$ 173.9	172.5	162.2	158.5	143.9
Backlog	\$ 1,098.2	1,005.2	994.2	833.3	785.2

Comparative periods of fiscal 2009 have been restated to reflect a change in the accounting treatment for pre-operating costs.

**Revenue down by 9% over last quarter and up by 3% year over year**

Revenue decreased from last quarter mainly due to lower training revenue this quarter from our Rotorsim joint venture and a negative foreign exchange impact. Furthermore, last quarter's revenue was higher due to a receipt recorded during that quarter relating to a contract amendment, in addition to positive annual labour rate adjustments related to military contracts in the U.S.

The year-over-year increase mainly stems from an increased level of effort on some maintenance service contracts, most notably in Canada and Germany, combined with training revenue from our NH90 joint venture HFTS in Germany, which was inaugurated in the fourth quarter of fiscal 2009. The increase was partially offset by lower training revenue from our Rotorsim joint venture.

Revenue year to date was \$127.1 million, 10% or \$11.8 million higher than the same period last year. The increase mainly stems from higher training revenue, most notably from our NH90 joint venture HFTS in Germany, which was inaugurated in the fourth quarter of fiscal 2009.

**Segment operating income down by 23% over last quarter and by 16% year over year**

Segment operating income was \$9.7 million (16.1% of revenue) this quarter, compared to \$12.6 million (18.9% of revenue) last quarter and \$11.5 million (19.7% of revenue) in the same period last year.

The decrease over last quarter was mainly due to the positive annual labour rate adjustments last quarter and a decrease in volume from our Rotorsim joint venture, as explained above.

The year-over-year decrease was mainly due to a lower dividend from a U.K.-based TS/M investment, lower training revenue from our Rotorsim joint venture and increased bid and proposal costs due to higher activity.

Segment operating income for the first six months of the year was \$22.3 million (17.5% of revenue), 6% or \$1.2 million higher than the same period last year. The increase was mainly due to increased volume and a positive foreign exchange impact.

**Capital employed increased by \$1.4 million over last quarter**

The increase over last quarter was mainly due to an increase in property, plant and equipment, partially offset by a decrease in non-cash working capital accounts.

**Backlog up by 9% over last quarter**

<i>(amounts in millions)</i>	Three months ended September 30, 2009	Six months ended September 30, 2009
Backlog, beginning of period	\$ 1,005.2	\$ 994.2
+ orders	64.9	129.1
- revenue	(60.4)	(127.1)
+ / - adjustments	88.5	102.0
Backlog, end of period	<u>\$ 1,098.2</u>	<u>\$ 1,098.2</u>

Adjustments include the negative foreign exchange impact and an amount of \$134.0 million of contracts transferred from SP/M's backlog to TS/M's backlog. The \$134.0 million represents certain contracts acquired in the DSA transaction that have now been identified as TS/M related. The transfer has no impact on the combined military backlog.

This quarter's book-to-sales ratio was 1.07x. The ratio for the last 12 months was 1.77x.

**Combined military performance**

Revenue was \$197.8 million this quarter, compared to \$185.2 million last quarter and \$184.4 million in the same period last year.

Segment operating income was \$34.0 million (17.2% of revenue) this quarter, compared to \$34.8 million (18.8% of revenue) last quarter and \$33.1 million (18.0% of revenue) in the same period last year.

The combined military book-to-sales ratio was 0.90x for the quarter and 1.41x 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			Six months ended	
		September 30	June 30	September 30	
	2009	2008	2009	2009	2008
Cash provided by continuing operating activities*	\$ 72.7	\$ 78.9	\$ 48.1	\$ 120.8	\$ 149.4
Changes in non-cash working capital	43.7	(19.9)	(68.0)	(24.3)	(119.0)
Net cash provided by (used in) continuing operations	\$ 116.4	\$ 59.0	\$ (19.9)	\$ 96.5	\$ 30.4
Maintenance capital expenditures	(12.8)	(7.8)	(8.3)	(21.1)	(13.3)
Other assets	(3.5)	(1.2)	(1.5)	(5.0)	(2.6)
Proceeds from the sale of property, plant and equipment	0.9	–	7.6	8.5	–
Cash dividends	(7.5)	(7.5)	(7.6)	(15.1)	(14.6)
Free cash flow <sup>11</sup>	\$ 93.5	\$ 42.5	\$ (29.7)	\$ 63.8	\$ (0.1)
Growth capital expenditures	(13.5)	(42.8)	(23.7)	(37.2)	(75.7)
Deferred development costs	(3.0)	(2.2)	(3.1)	(6.1)	(4.1)
Other cash movements, net	1.3	(0.3)	0.7	2.0	7.1
Business acquisitions (net of cash and cash equivalents acquired)	(5.2)	0.1	(17.7)	(22.9)	(38.7)
Effect of foreign exchange rate changes on cash and cash equivalents	(9.9)	(0.5)	(5.9)	(15.8)	(2.8)
Net increase (decrease) in cash before proceeds and repayment of long-term debt	\$ 63.2	\$ (3.2)	\$ (79.4)	\$ (16.2)	\$ (114.3)

\* before changes in non-cash working capital

Comparative periods of fiscal 2009 have been restated to reflect a change in the accounting treatment for pre-operating costs.

#### Free cash flow of \$93.5 million, up \$123.2 million from last quarter and up \$51.0 million year over year

The increase over last quarter was mainly attributable to a decreased investment in non-cash working capital and to an increase in cash provided by continuing operating activities of \$24.6 million.

The increase year over year was mainly due to a decreased investment in non-cash working capital, partially offset by a decrease of \$6.2 million in cash provided by continuing operating activities and an increase in maintenance capital expenditures of \$5.0 million.

Free cash flow year to date was \$63.8 million, \$63.9 million higher than in the same period last year. The increase was mainly attributable to a decreased investment in non-cash working capital and proceeds from the disposal of property, plant and equipment of \$8.5 million this year (nil last year), partially offset by a decrease in cash provided by continuing operating activities of \$28.6 million and an increase in maintenance capital expenditures of \$7.8 million.

#### Capital expenditures of \$26.3 million this quarter and \$58.3 million in the first half of fiscal 2010

Growth capital expenditures<sup>12</sup> of \$13.5 million this quarter and \$37.2 million for the first half of fiscal 2010 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 for our customers. Maintenance capital expenditures<sup>13</sup> were \$12.8 million this quarter and \$21.1 million for the first half of fiscal 2010.

<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 and adding proceeds from the sale of property, plant and equipment.

<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 the current level of economic activity.

## 8. CONSOLIDATED FINANCIAL POSITION

### 8.1 Consolidated capital employed

<i>(amounts in millions)</i>	As at September 30 2009	As at June 30 2009	As at March 31 2009
<b>Use of capital:</b>			
Non-cash working capital	\$ (15.3)	\$ 19.2	\$ (60.4)
Property, plant and equipment, net	1,202.5	1,266.6	1,302.4
Other long-term assets	468.1	466.5	463.5
Other long-term liabilities	(233.6)	(227.2)	(222.6)
<b>Total capital employed</b>	<b>\$ 1,421.7</b>	<b>\$ 1,525.1</b>	<b>\$ 1,482.9</b>
<b>Source of capital:</b>			
Net debt	\$ 257.8	\$ 340.7	\$ 285.1
Shareholders' equity	1,163.9	1,184.4	1,197.8
<b>Source of capital</b>	<b>\$ 1,421.7</b>	<b>\$ 1,525.1</b>	<b>\$ 1,482.9</b>

Comparative periods of fiscal 2009 have been restated to reflect a change in the accounting treatment for pre-operating costs.

#### Capital employed<sup>14</sup> decreased 7% this quarter over last quarter

The decrease was mainly the result of lower property, plant, and equipment and non-cash working capital, as well as to higher other long-term liabilities.

Our return on capital employed<sup>15</sup> (ROCE) was 12.9% (12.1% adjusted for operating leases) this quarter compared to 17.1% (15.1% adjusted for operating leases) for the second quarter of last year.

#### Non-cash working capital<sup>16</sup> decreased by \$34.5 million this quarter from last quarter

The decrease was mainly due to an increase in deposits on contracts and a decrease in accounts receivable and contracts in progress, partially offset by a decrease in accounts payable and accrued liabilities.

#### Net property, plant and equipment down \$64.1 million this quarter over last quarter

The decrease was mainly caused by foreign exchange variations of \$77.9 million and depreciation of \$18.2 million, partially offset by capital expenditures of \$26.3 million.

#### Net debt<sup>17</sup> decreased by \$82.9 million this quarter

The decrease of \$82.9 million was primarily caused by a net increase in cash before proceeds and repayments of long-term debt and by the strengthening of the Canadian dollar against our foreign denominated debt.

<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 expense, 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.

<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.

**Change in net debt**

<i>(amounts in millions)</i>	Three months ended September 30, 2009	Six months ended September 30, 2009
Net debt, beginning of period	\$ 340.7	\$ 285.1
Impact of cash movements on net debt (see table in the consolidated cash movements section)	(63.2)	16.2
Business acquisitions, joint ventures and others	15.0	13.1
Effect of foreign exchange rate changes on long-term debt	(34.7)	(56.6)
Decrease in net debt during the period	\$ (82.9)	\$ (27.3)
Net debt, end of period	\$ 257.8	\$ 257.8

In June 2009, pursuant to a private placement, we issued debt of \$15.0 million and US\$105.0 million. \$15.0 million and US\$45.0 million mature in June 2016 and bear interest rates of 6.58% and 6.65% respectively. The remaining US\$60.0 million matures in June 2019 and bears an interest rate of 7.66%. Of the total proceeds, US\$60.0 million was used to pay maturing notes under the 1997 Note issue, with the balance of proceeds to be used for general corporate purposes.

During this quarter, we began reporting our proportionate interest in the debt of the joint venture Rotorsim S.r.l. of €8.9 million.

In September 2009, we issued a debt of \$5.4 million that matures in September 2016 and that bears interest at a rate of 3.94% for ERP financing.

In managing our liquidity risk, we have access to revolving unsecured term credit facilities of US\$400.0 million and €100.0 million. At September 30, 2009, we had US\$136.3 million and €nil million outstanding for letters of credit under the credit facility, compared to US\$114.8 million and €nil used for letters of credit at June 30, 2009.

We also have an agreement to sell certain of our accounts receivable up to \$50 million.

We continue to monitor our cash flows to ensure that we have adequate cash resources to meet our obligations and commitments as they become due. Additionally, despite the tight credit markets and aerospace industry downturn, our ability to refinance maturing debt demonstrates our ability to access the capital markets.

**Shareholders' equity decreased by \$20.5 million this quarter**

The decrease in equity was mainly due to an increase in the accumulated other comprehensive loss of \$54.6 million and dividends of \$7.5 million, partially offset by net earnings of \$39.1 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 255,803,374 common shares issued and outstanding as at September 30, 2009 with total share capital of \$435.5 million.

As at October 30, 2009, we had a total of 255,815,247 common shares issued and outstanding.

**9. BUSINESS ACQUISITIONS****Bell Aliant's Defence, Security and Aerospace**

In May 2009, we acquired Bell Aliant's Defence, Security and Aerospace (DSA) business unit, through an asset purchase agreement for a total cost, including acquisition costs, and excluding a working capital adjustment, of \$17.7 million payable in cash. DSA supplies real-time software and systems for simulation training defence and integrated lifecycle information management for the aerospace and defence industries. The total cost does not include potential additional considerations of \$8.5 million that are contingent on certain conditions being satisfied, which, if met, would be recorded as additional goodwill.

During the quarter, we revised our valuation of the identifiable intangible assets. Consequently, customer relationship was increased by \$2.8 million and goodwill was reduced accordingly. The allocation of the purchase price remains preliminary and is expected to be completed in the near future.

**Seaweed Systems Inc.**

In August 2009, we acquired Seaweed Systems Inc. (Seaweed) for a total cost, including acquisition costs and excluding working capital adjustment, of \$6.7 million of which \$5.6 million was settled in cash. Seaweed is a leader in embedded graphics solutions for the military and aerospace market, with noted experience in the development of safety critical graphic drivers. The allocation of the purchase price is preliminary and is expected to be completed in the near future.

Goodwill recognized for these transactions amounts to \$7.2 million of which \$2.5 million is deductible for tax purposes. As well, customer relationship intangible assets in the amount of \$9.6 million and a technology intangible asset in the amount of \$1.7 million have been recognized regarding these transactions. These transactions were accounted for under the purchase method and the operating results have been included in our consolidated results since the date of each respective acquisition. The net assets of these acquisitions are included in the SP/M and TS/M segments.

## 10. CHANGE IN ACCOUNTING STANDARDS

We prepare our financial statements in accordance with 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 Abstracts.

### **Intangible assets**

Effective April 1, 2009, we adopted CICA Handbook Section 3064, *Goodwill and Intangible Assets*, which replaced Sections 3062, *Goodwill and Other Intangible Assets*, and 3450, *Research and Development Costs*. New Section 3064 incorporates material from International Accounting Standard (IAS) 38, *Intangible Assets*, addressing when an internally developed intangible asset meets the criteria for recognition as an asset. EIC-27, *Revenues and Expenditures during the Pre-Operating Period*, no longer applies to entities that have adopted Section 3064.

Since adopting the new standard, we expense our pre-operating costs as they are incurred. The impact of adopting this accounting standard, on a retrospective basis, to our consolidated statement of earnings for years ended March 31 is:

<i>(amounts in millions)</i>	2009	2008
Deferred pre-operating costs, net of non-cash items	\$ 2.2	\$ (0.9)
Income tax adjustment	(0.5)	(0.5)
Adjustment to net earnings	\$ 1.7	\$ (1.4)

As at March 31, 2009, the impact of adopting this change to other assets on our consolidated balance sheet was a decrease of \$10.4 million. The retained earnings at April 1, 2007, decreased by \$8.6 million, net of tax recovery of \$3.6 million.

Our treatment regarding R&D costs was not impacted as a result of this change in accounting standard. Upon adoption of Section 3064, we have reclassified our deferred development costs from other assets to intangible assets.

## 11. INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) IMPLEMENTATION

In February 2008, the Canadian Accounting Standards Board (AcSB) confirmed January 1, 2011 as the date IFRS will replace current Canadian GAAP for publicly accountable enterprises. While Canadian GAAP and IFRS are both principles-based and use comparable conceptual frameworks, there are significant recognition, measurement, presentation and disclosure differences.

Reporting under IFRS is required for our interim and annual financial statements beginning on April 1, 2011. We have developed a detailed changeover plan to convert our consolidated financial statements from Canadian GAAP to IFRS. Details regarding the phases, key activities and the status of the plan, as well as some of our preliminary accounting policy decisions are described in Section 10.2 *Future changes in accounting standards* of our 2009 MD&A dated May 14, 2009.

No significant changes to the plan have been made since this date and the plan is progressing as intended. As the International Accounting Standards Board (IASB) work plan anticipates the completion of several significant projects in calendar years 2010 and 2011, we continue to track the progress of these projects. However, it is difficult to predict the IFRS that will be effective at the end of our first IFRS reporting period. Our decisions may change if previously unconsidered new standards or amendments are introduced before our changeover date.

## 12. CONTROLS AND PROCEDURES

### 12.1 Evaluation of disclosure controls and procedures

In the second quarter ended September 30, 2009, 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 second 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)</i> <i>(amounts in millions, except per share amounts and exchange rates)</i>	Q1	Q2	Q3	Q4	Year to date
<b>Fiscal 2010</b>					
Revenue	\$ 383.0	364.5	(1)	(1)	747.5
Earnings from continuing operations	\$ 27.2	39.1	(1)	(1)	66.3
Basic earnings per share from continuing operations	\$ 0.11	0.15	(1)	(1)	0.26
Diluted earnings per share from continuing operations	\$ 0.11	0.15	(1)	(1)	0.26
Net earnings	\$ 27.2	39.1	(1)	(1)	66.3
Basic earnings per share	\$ 0.11	0.15	(1)	(1)	0.26
Diluted earnings per share	\$ 0.11	0.15	(1)	(1)	0.26
Average number of shares outstanding (basic)	255.4	255.6	(1)	(1)	255.5
Average number of shares outstanding (diluted)	255.4 <sup>(2)</sup>	255.6 <sup>(2)</sup>	(1)	(1)	255.5 <sup>(2)</sup>
Average exchange rate, U.S. dollar to Canadian dollar	1.17	1.10	(1)	(1)	1.13
<b>Fiscal 2009 – Restated<sup>(3)</sup></b>					
					Total
Revenue	\$ 392.1	406.7	424.6	438.8	1,662.2
Earnings from continuing operations	\$ 48.2	49.2	52.1	52.7	202.2
Basic earnings per share from continuing operations	\$ 0.19	0.19	0.20	0.21	0.79
Diluted earnings per share from continuing operations	\$ 0.19	0.19	0.20	0.21	0.79
Net earnings	\$ 47.3	49.0	52.1	52.7	201.1
Basic earnings per share	\$ 0.19	0.19	0.20	0.21	0.79
Diluted earnings per share	\$ 0.19	0.19	0.20	0.21	0.79
Average number of shares outstanding (basic)	254.3	254.9	254.9	254.9	254.8
Average number of shares outstanding (diluted)	255.1	255.4	254.9 <sup>(2)</sup>	254.9 <sup>(2)</sup>	255.0
Average exchange rate, U.S. dollar to Canadian dollar	1.01	1.04	1.21	1.25	1.13
<b>Fiscal 2008 – Restated<sup>(3)</sup></b>					
					Total
Revenue	\$ 358.3	353.9	344.8	366.6	1,423.6
Earnings from continuing operations	\$ 38.5	39.2	41.1	44.6	163.4
Basic earnings per share from continuing operations	\$ 0.15	0.15	0.16	0.18	0.64
Diluted earnings per share from continuing operations	\$ 0.15	0.15	0.16	0.17	0.64
Net earnings	\$ 38.5	39.1	40.5	33.2	151.3
Basic earnings per share	\$ 0.15	0.15	0.16	0.13	0.60
Diluted earnings per share	\$ 0.15	0.15	0.16	0.13	0.59
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
Average exchange rate, U.S. dollar to Canadian dollar	1.10	1.04	0.98	1.00	1.03

<sup>(1)</sup> Not available.

<sup>(2)</sup> For the three months ended September 30, 2009, June 30, 2009, March 31, 2009, and 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.

<sup>(3)</sup> Comparative periods of fiscal 2009 and fiscal 2008 have been restated to reflect a change in the accounting treatment for pre-operating costs.