

## Consolidated Balance Sheets

(Unaudited) (amounts in millions of Canadian dollars)	As at December 31 2007	As at March 31 2007
<b>Assets</b>		
<i>Current assets</i>		
Cash and cash equivalents	\$ 201.0	\$ 150.2
Accounts receivable	264.8	219.8
Inventories	212.2	203.8
Prepaid expenses	31.5	23.5
Income taxes recoverable	39.7	24.7
Future income taxes	8.3	3.7
	<b>757.5</b>	<b>625.7</b>
Property, plant and equipment, net	948.5	986.6
Future income taxes	62.1	81.5
Intangible assets	58.7	36.0
Goodwill	111.0	96.9
Other assets	132.6	129.5
	<b>\$ 2,070.4</b>	<b>\$ 1,956.2</b>
<b>Liabilities and Shareholders' Equity</b>		
<i>Current liabilities</i>		
Accounts payable and accrued liabilities	\$ 371.4	\$ 403.9
Deposits on contracts	209.2	184.8
Current portion of long-term debt	26.7	27.2
Future income taxes	10.9	4.9
	<b>618.2</b>	<b>620.8</b>
Long-term debt (Note 5 )	361.5	256.0
Deferred gains and other long-term liabilities	191.5	232.7
Future income taxes	33.6	16.8
	<b>1,204.8</b>	<b>1,126.3</b>
<b>Shareholders' Equity</b>		
Capital stock (Note 7)	418.5	401.7
Contributed surplus	6.3	5.7
Retained earnings	611.4	510.2
Accumulated other comprehensive loss (Note 8)	(170.6)	(87.7)
	<b>865.6</b>	<b>829.9</b>
	<b>\$ 2,070.4</b>	<b>\$ 1,956.2</b>

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

## Consolidated Statements of Earnings

(Unaudited) (amounts in millions of Canadian dollars, except per share amounts)	Three months ended December 31		Nine months ended December 31	
	2007	2006	2007	2006
Revenue	\$ 344.8	\$ 331.2	\$ 1,057.0	\$ 913.4
Earnings before interest and income taxes (Note 12)	\$ 61.7	\$ 44.2	\$ 181.8	\$ 136.1
Interest expense, net (Note 5)	4.8	2.9	12.8	7.1
Earnings before income taxes	\$ 56.9	\$ 41.3	\$ 169.0	\$ 129.0
Income tax expense	16.8	11.6	51.2	35.0
Earnings from continuing operations	\$ 40.1	\$ 29.7	\$ 117.8	\$ 94.0
Results of discontinued operations (Note 6)	(0.6)	-	(0.7)	(0.9)
<b>Net earnings</b>	<b>\$ 39.5</b>	<b>\$ 29.7</b>	<b>\$ 117.1</b>	<b>\$ 93.1</b>
<b>Basic earnings per share from continuing operations</b>	<b>\$ 0.16</b>	<b>\$ 0.12</b>	<b>\$ 0.47</b>	<b>\$ 0.37</b>
<b>Diluted earnings per share from continuing operations</b>	<b>\$ 0.16</b>	<b>\$ 0.12</b>	<b>\$ 0.46</b>	<b>\$ 0.37</b>
<b>Basic and diluted earnings per share</b>	<b>\$ 0.16</b>	<b>\$ 0.12</b>	<b>\$ 0.46</b>	<b>\$ 0.37</b>
Weighted average number of shares outstanding (Basic)	253.8	251.2	253.2	251.0
Weighted average number of shares outstanding (Diluted)	254.8	253.3	254.4	252.8

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

## Consolidated Statements of Retained Earnings

(Unaudited) (amounts in millions of Canadian dollars)	Three months ended December 31		Nine months ended December 31	
	2007	2006	2007	2006
Retained earnings at beginning of period	\$ 574.4	\$ 451.2	\$ 510.2	\$ 392.8
Transition adjustments – Financial instruments (Note 2)	-	-	(8.3)	-
Net earnings	39.5	29.7	117.1	93.1
Dividends	(2.5)	(2.5)	(7.6)	(7.5)
Retained earnings at end of period	\$ 611.4	\$ 478.4	\$ 611.4	\$ 478.4

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

## Consolidated Statements of Comprehensive Income

(Unaudited) (amounts in millions of Canadian dollars)	Three months ended December 31		Nine months ended December 31	
	2007	2006	2007	2006
<b>Net earnings</b>	\$ 39.5	\$ 29.7	\$ 117.1	\$ 93.1
Other comprehensive (loss) income, net of income taxes:				
<b>Foreign Currency Translation Adjustment</b>				
Net foreign exchange (losses) gains on translating financial statements of self-sustaining foreign operations	\$ (3.3)	\$ 45.1	\$ (113.9)	\$ 29.1
Net change in gains (losses) on certain long-term debt denominated in foreign currency and designated as hedges on net investments of self-sustaining foreign operations	2.4	(5.4)	17.0	0.2
Income tax adjustment	(0.3)	0.1	0.6	(0.1)
	\$ (1.2)	\$ 39.8	\$ (96.3)	\$ 29.2
<b>Net Changes in Cash Flow Hedge</b>				
Net change in (losses) gains on derivative items designated as hedges of cash flows	\$ (3.7)	\$ -	\$ 24.9	\$ -
Income tax adjustment	1.3	-	(8.0)	-
	\$ (2.4)	\$ -	\$ 16.9	\$ -
<b>Total other comprehensive (loss) income</b>	\$ (3.6)	\$ 39.8	\$ (79.4)	\$ 29.2
<b>Comprehensive income</b>	\$ 35.9	\$ 69.5	\$ 37.7	\$ 122.3

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

## Consolidated Statements of Cash Flows

(Unaudited) (amounts in millions of Canadian dollars)	Three months ended December 31		Nine months ended December 31	
	2007	2006	2007	2006
<b>Operating activities</b>				
Net earnings	\$ 39.5	\$ 29.7	\$ 117.1	\$ 93.1
Results of discontinued operations	0.6	-	0.7	0.9
Earnings from continuing operations	40.1	29.7	117.8	94.0
Adjustments to reconcile earnings to cash flows from operating activities:				
Depreciation	15.3	14.3	45.5	40.4
Financing cost amortization	0.1	0.2	0.6	0.6
Amortization and write down of intangible and other assets	4.2	3.4	12.7	10.6
Future income taxes	20.0	(1.2)	30.1	11.4
Investment tax credits	2.3	9.6	9.8	5.5
Stock-based compensation plans	1.4	6.4	0.3	14.4
Employee future benefits, net	(0.1)	(0.2)	(0.3)	(0.5)
Other	1.4	(4.3)	2.4	(2.8)
Changes in non-cash working capital (Note 9)	(23.7)	18.1	(88.9)	(26.5)
<b>Net cash provided by operating activities</b>	<b>61.0</b>	<b>76.0</b>	<b>130.0</b>	<b>147.1</b>
<b>Investing activities</b>				
Business acquisitions (net of cash and cash equivalents acquired) (Note 3)	-	(4.9)	(40.7)	(4.9)
Proceeds from disposal of discontinued operations (Note 9)	-	-	-	(6.6)
Capital expenditures	(21.1)	(42.7)	(141.2)	(124.3)
Deferred development costs	(4.2)	(0.1)	(13.9)	(0.3)
Deferred pre-operating costs	(0.5)	(2.6)	(0.9)	(2.7)
Other	(0.9)	(1.1)	(4.3)	2.6
<b>Net cash used in investing activities</b>	<b>(26.7)</b>	<b>(51.4)</b>	<b>(201.0)</b>	<b>(136.2)</b>
<b>Financing activities</b>				
Net borrowing under revolving unsecured credit facilities	15.0	(30.6)	30.0	(0.6)
Proceeds from long-term debt, net of transaction costs and debt basis adjustment (Note 5)	15.7	8.0	125.1	32.5
Reimbursement of long-term debt	(4.5)	(3.6)	(20.9)	(11.2)
Dividends paid	(2.5)	(2.4)	(7.4)	(7.3)
Common stock issuance	0.2	0.9	13.7	3.6
Other	(1.3)	(1.6)	(5.8)	(1.0)
<b>Net cash provided by (used in) financing activities</b>	<b>22.6</b>	<b>(29.3)</b>	<b>134.7</b>	<b>16.0</b>
<b>Effect of foreign exchange rate changes on cash and cash equivalents</b>	<b>(0.2)</b>	<b>6.8</b>	<b>(12.9)</b>	<b>4.9</b>
<b>Net increase in cash and cash equivalents</b>	<b>56.7</b>	<b>2.1</b>	<b>50.8</b>	<b>31.8</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>144.3</b>	<b>110.8</b>	<b>150.2</b>	<b>81.1</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 201.0</b>	<b>\$ 112.9</b>	<b>\$ 201.0</b>	<b>\$ 112.9</b>

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

## Notes to Consolidated Financial Statements (Unaudited)

### Note 1: Nature of Operations and Significant Accounting Policies

#### **Nature of Operations**

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

The Company's operations are managed through four segments:

- (i) Simulation Products/Civil – Designs, manufactures and supplies civil flight simulators, training devices and visual systems.
- (ii) Simulation Products/Military – Designs, manufactures and supplies advanced military training products for air, land and sea applications.
- (iii) Training & Services/Civil – Provides business and commercial aviation training and related services.
- (iv) Training & Services/Military – Supplies military turnkey training and operational solutions, support services, life extensions, systems maintenance and modelling and simulation solutions.

#### **Seasonality and Cyclicity of the Business**

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

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

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

#### **Use of Estimates**

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

### **Generally Accepted Accounting Principles and Financial Statement Presentation**

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

These consolidated financial statements comply with generally accepted accounting principles applicable to interim financial statements and, except as otherwise indicated hereunder, have been prepared on a basis consistent with the Company's annual consolidated financial statements for the year ended March 31, 2007 except for the adoption of the accounting standards described in Note 2.

These consolidated statements do not include all of the disclosures applicable to annual consolidated financial statements; for a full description of the Company's accounting policies, refer to the Company's annual consolidated financial statements for the year ended March 31, 2007 available on-line at [www.sedar.com](http://www.sedar.com), at [www.sec.gov](http://www.sec.gov), as well as on the Company's website at [www.cae.com](http://www.cae.com). While Management believes that the disclosures presented are adequate and that the disclosures highlight all material changes during the quarter, these interim consolidated financial statements should be read in conjunction with the most recent annual consolidated financial statements.

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

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

### **Basis of Consolidation**

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

## **Note 2: Change in Accounting Policies**

### **Accounting Changes**

On April 1, 2007, the Company adopted CICA Handbook Section 1506, *Accounting Changes*. This standard establishes criteria for changing accounting policies, along with the accounting treatment and disclosure regarding changes in accounting policies, estimates and correction of errors.

### **Financial Instruments**

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

The Company's adoption of these financial instruments standards resulted in changes in the accounting for financial instruments and hedges. The impact of these new standards is presented as a transitional adjustment in opening retained earnings and opening accumulated other comprehensive loss, as applicable. The comparative interim consolidated financial statements have not been restated except for the foreign currency translation adjustment, which is now disclosed as a part of accumulated other comprehensive loss. The resulting changes in the accounting for financial instruments and hedges due to the adoption of these accounting standards are described further.

- (i) **Comprehensive Income (loss)**  
Comprehensive income (loss), established under CICA Section 1530, is a standard that provides guidance on the presentation of comprehensive income (loss) which is defined as the change in shareholders' equity, from transactions and other events and circumstances from non-owner sources, and is composed of the Company's net earnings (loss) and other comprehensive income (loss).

Other comprehensive income (loss) refers to revenues, expenses, gains and losses that are recognized in comprehensive income (loss), but excluded from net earnings (loss), and includes net changes in unrealized foreign exchange gains (losses) on translating financial statements of self-sustaining foreign operations, net changes in gains (losses) on items designated as hedges on net investments including reclassification to earnings and net changes in gains (losses) on derivative items designated as hedges of cash flows and net changes on financial assets classified as available for sale, all net of income taxes.

- (ii) **Financial Assets and Financial Liabilities**  
Section 3855 requires that financial assets and financial liabilities, including derivative financial instruments, be recognized on the consolidated balance sheet when the Company becomes a party to the contractual provisions of the financial instrument. On initial recognition, all financial instruments subject to Section 3855, including embedded derivative financial instruments that are not clearly and closely related to the host contract, must be measured at fair value. Financial assets and financial liabilities are initially recognized at fair value and are classified into one of these five categories: held-for-trading, held-to-maturity investments, loans and receivables, other financial liabilities and available-for-sale financial instruments. They are subsequently accounted for based on their classification as described below. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Except in very limited circumstances, the classification is not changed subsequent to initial recognition.

*Held-for-trading*

Financial instruments classified as held-for-trading are carried at fair value at each balance sheet date with the changes in fair value recorded in net earnings in the period in which these changes arise. Section 3855 allows an entity to designate any financial instrument as held-for-trading on initial recognition or adoption of the accounting standard if reliable fair values are available, even if that instrument would not otherwise satisfy the definition of held-for-trading (fair value option).

*Held-to-maturity investments, loans and receivables and other financial liabilities*

Financial instruments classified as loans and receivables, held-to-maturity investments and other financial liabilities are carried at amortized cost using the effective interest method. The interest income or expense is included in net earnings in the period. The Company's long-term debt, including related debt issue costs, is accounted for at the amortized cost using the effective interest method.

*Available-for-sale*

Financial instruments classified as available-for-sale are carried at fair value at each balance sheet date with the changes in fair value recorded in other comprehensive income (loss) in the period in which the change arise. Securities that are classified as available-for-sale and do not have a readily available market value are recorded at cost. Available-for-sale securities are written down to fair value through earnings whenever it is necessary to reflect other-than-temporary impairment. Upon de-recognition, all cumulative gains or losses are then recognized in net earnings.

As a result of the adoption of these new standards, the Company has classified its cash and cash equivalents as held-for-trading. Accounts receivable are classified as loans and receivables. Except for a minority interest investment classified as available-for-sale, the Company's investments consist of equity of entities subject to significant influence and joint

ventures which are excluded from the scope of this standard. Accounts payable and accrued liabilities and long-term debt, including interest payable, are classified as other financial liabilities, all of which are measured at amortized cost. All derivative instruments are classified as held-for-trading.

(iii) Derivatives and hedge accounting

*Derivatives*

All derivative instruments are recorded in the consolidated balance sheets at fair value at each balance sheet date. Derivatives may be embedded in other financial instruments (host instrument). Prior to the adoption of the new standards, such embedded derivatives were not accounted for separately from the host instrument. Under the new standards, embedded derivatives are treated as separate derivatives if their economic characteristics and risks are not clearly and closely related to those of the host instrument, the terms of the embedded derivative are the same as those of a stand-alone derivative, and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value at each balance sheet date with subsequent changes recognized in net earnings in the period in which the changes arise.

*Hedge accounting*

Under the new standards, all derivatives are recorded at fair value. The method of recognizing fair value gains and losses depends on whether derivatives are held for trading or are designated as hedging instruments, and, if the latter, the nature of the risks being hedged. All gains and losses from changes in the fair value of derivatives not designated as hedges are recognized in the consolidated statements of earnings. When derivatives are designated as hedges, the Company classifies them either as: (a) hedges of the change in fair value of recognized assets or liabilities or firm commitments (fair value hedges); or (b) hedges of the variability in highly probably future cash flows attributable to a recognized asset or liability, or a forecasted transaction (cash flow hedges).

*Fair value hedge*

The Company has outstanding interest rate swap contracts, which it designates as a fair value hedge related to variations of the fair value of its long-term debt due to change in LIBOR interest rates. In a fair value hedge relationship, gains or losses from the measurement of derivative hedging instruments at fair value are recorded in earnings, while gains or losses on hedged items attributable to the hedged risks are accounted for as an adjustment to the carrying amount of hedged items and are recorded in earnings.

*Cash flow hedge*

The Company has forward exchange contracts, which it designates as cash flow hedges of anticipated future cash receipts. The amounts and timing of future cash flows are projected on the basis of their contractual terms and estimated progress on projects. The aggregate cash flows over time form the basis for identifying the effective portion of gains and losses on the derivatives instruments designated as cash flow hedges of forecasted transactions. The effective portion of changes in the fair value of derivative instruments that are designated and qualify as cash flow hedges is recognized in comprehensive income (loss). Any gain or loss in fair value relating to the ineffective portion is recognized immediately in earnings. Amounts accumulated in other comprehensive income (loss) are reclassified to the consolidated statements of earnings in the period in which the hedged item affects earnings. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in other comprehensive income (loss) at that time remains in other comprehensive income (loss) until the forecasted transaction is eventually recognized in the consolidated statements of earnings. When it is probable that a forecasted transaction will not occur, the cumulative gain or loss that was reported in other comprehensive income (loss) is recognized immediately in earnings.

(iv) *Deferred financing fees*

Under the new standards, transaction costs related to the issuance or acquisition of financial assets and liabilities (other than those classified as held-for-trading) may be either all recognized into earnings as incurred, or are recorded with the asset or liability to which they are associated and amortized using the effective-interest rate method. Previously, the Company had deferred these costs and amortized them over the life of the related financial asset or liability.

The Company elected to record transaction costs with the asset or liability to which they are associated and amortize them using the effective-interest rate method. As a result, the Company reclassified deferred financing costs, resulting in an adjustment to long-term debt on April 1, 2007.

The impact on the consolidated balance sheet was as follows as at April 1, 2007:

(Unaudited) (amounts in millions)	Reclassification	Increase (decrease)	Total
<b>Assets</b>			
Accounts receivable	\$ -	\$ 7.8	\$ 7.8
Inventories	-	1.2	1.2
Income taxes recoverable	-	5.5	5.5
Property, plant and equipment, net	-	(0.7)	(0.7)
Other assets	(1.5)	4.4	2.9
	<u>\$ (1.5)</u>	<u>\$ 18.2</u>	<u>\$ 16.7</u>
<b>Liabilities</b>			
Accounts payable and accrued liabilities	\$ -	\$ 7.7	\$ 7.7
Deposits on contracts	-	3.2	3.2
Current portion of long-term debt	(0.1)	-	(0.1)
Long-term debt	(1.4)	2.5	1.1
Deferred gains and other long-term liabilities	-	16.6	16.6
	<u>(1.5)</u>	<u>30.0</u>	<u>28.5</u>
<b>Shareholders' Equity</b>			
Retained earnings	\$ -	\$ (8.3)	\$ (8.3)
Accumulated other comprehensive loss	-	(3.5)	(3.5)
	<u>\$ (1.5)</u>	<u>\$ 18.2</u>	<u>\$ 16.7</u>

The following table summarizes the required transition adjustments upon adoption of the relevant standards as at April 1, 2007:

(Unaudited) (amounts in millions)	Retained Earnings	Accumulated Other Comprehensive loss
Financial instruments classified as held-for-trading	\$ (0.3)	\$ -
Effect of discontinued hedging relations	(2.6)	-
Carrying value difference of financial instruments recognized as held-to- maturity, loans and receivables and other financial liabilities carried at amortized cost using the effective interest method	(0.1)	-
Fair value of cash flow hedges	(0.1)	(6.0)
Effect of initial recognition of embedded derivatives	(9.4)	-
Other	0.3	0.9
Income tax adjustment	3.9	1.6
	<u>\$ (8.3)</u>	<u>\$ (3.5)</u>

All derivative financial instruments, including embedded derivatives that are not clearly and closely related to those of the host instrument, are recorded on the consolidated balance sheet at fair value. Short-term and long-term derivative assets have been included as part of accounts receivable and other assets respectively, while short-term and long-term derivative liabilities have been included as part of accounts payable and accrued liabilities and deferred gains and other long-term liabilities, in that order. Gains and losses of financial instruments classified as held-for-trading, net of taxes, including derivatives not qualifying for hedge accounting in accordance with the new standards and which were not previously recorded at fair value, have been recognized in the opening balance of retained earnings. Adjustments, net of taxes, arising from the difference at transition between the carrying value of financial instruments recognized as held-to-maturity, loans and receivables and other financial liabilities carried at amortized cost using the effective interest method and their carrying value as at March 31, 2007, have been recognized in the opening balance of retained earnings. Other adjustments including those arising as a result of re-measuring hedging instruments designated as cash flow hedges are recognized in the opening balance of accumulated other comprehensive income and opening retained earnings, net of taxes. The effects of the initial recognition of embedded derivatives have been recognized in the opening balance of retained earnings. Finally, the cumulative translation adjustment balance previously disclosed as a separate component of shareholders' equity has been reclassified to accumulated other comprehensive income.

### Note 3: Business Acquisitions

During the current fiscal year, the Company acquired four businesses for a total cost, including acquisition costs, of \$50.2 million which was payable primarily in cash. The total costs do not include potential additional consideration of \$12 million that is contingent on certain conditions being satisfied, which, if met, would be recorded as additional goodwill.

Goodwill and intangible assets recognized in these transactions amounted to \$28.3 million and \$28.2 million respectively. Intangible assets are composed of trade names amounting to \$1.5 million, technology totaling \$20.8 million and customer relationships in the amount of \$5.9 million. The goodwill is not deductible for tax purposes.

The net assets of Engenuity are segregated between the Simulation Products/Military and Training & Services/Military segments. The net assets of MultiGen and Macmet are included in the Simulation Products/Military segment. The net assets of Flightscope are included in the Training & Services/Civil segment.

The acquisitions were accounted for under the purchase method and the operating results have been included from their acquisition date.

**Engenuity Technologies Inc.**

During the first quarter of fiscal 2008, the Company acquired Engenuity Technologies Inc. (Engenuity) which develops commercial-off-the-shelf (COTS) simulation and visualization software for the aerospace and defence markets.

**MultiGen-Paradigm Inc.**

In May 2007, the Company acquired MultiGen-Paradigm Inc. (MultiGen), a supplier of real-time COTS software for creating and visualizing simulation solutions and creates industry standard visual simulation file formats.

**Macmet Technologies Limited**

In July 2007, the Company acquired 76% of the outstanding shares of Macmet Technologies Limited (Macmet). Macmet assembles, repairs and upgrades flight simulators, tank and gunnery trainers, as well as develops software required for simulations.

**Flightscape Inc.**

In August 2007, the Company acquired Flightscape Inc. (Flightscape), which provides expertise in flight data analysis and flight sciences and develops software solutions that enable the effective study and understanding of recorded flight data to improve safety, maintenance and flight operations.

#### Note 4: Investments in Joint Ventures

The Company's consolidated balance sheets as at December 31, 2007 and as at March 31, 2007 and consolidated statements of earnings and cash flows for the three and nine months ended December 31, 2007 and 2006, include, on a proportionate consolidation basis, the impact of its joint venture companies of Zhuhai Xiang Yi Aviation Technology Company Limited - 49%, Helicopter Training Media International GmbH - 50%, Helicopter Flight Training Services GmbH - 25% and the Emirates-CAE Flight Training centre - 50%.

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

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

(Unaudited) (amounts in millions)	As at December 31 2007		As at March 31 2007	
<b>Assets</b>				
Current assets	\$	32.4	\$	24.5
Property, plant and equipment and other non-current assets		149.3		159.4
<b>Liabilities</b>				
Current liabilities	\$	19.5	\$	12.0
Long-term debt (including current portion)		67.0		59.2

(Unaudited) (amounts in millions)	Three months ended December 31 2007		2006		Nine months ended December 31 2007		2006	
<b>Earnings</b>								
Revenue	\$	12.1	\$	6.1	\$	40.8	\$	40.0
Net earnings		3.1		1.3		8.3		5.2
Segmented operating income:								
Simulation Products/Military		0.3		0.3		1.1		1.5
Training and Services/Civil		3.6		1.8		9.2		4.8
Training and Services/Military		(0.3)		(0.1)		(0.4)		(0.1)

(Unaudited) (amounts in millions)	Three months ended December 31 2007		2006		Nine months ended December 31 2007		2006	
<b>Cash flows from (used in)</b>								
Operating activities	\$	(1.9)	\$	10.1	\$	12.8	\$	10.2
Investing activities		(4.8)		(6.7)		(16.1)		(35.0)
Financing activities		1.6		7.3		15.0		24.5

## Note 5: Debt Facilities

### **Long-term debt**

During the third quarter of fiscal 2008, the Company drew down an additional \$12.4 million, net of financing costs, from the senior secured financing facility obtained during the first quarter of fiscal 2008. As at December 31, 2007, the aggregate year-to-date draw down from that financing amounted to \$104.6 million, net of financing costs.

### **Interest expense, net**

Details of interest expense (income) are as follows:

(Unaudited) (amounts in millions)	Three months ended December 31 2007		2006		Nine months ended December 31 2007		2006	
Long-term debt interest expense	\$	6.6	\$	4.7	\$	17.5	\$	13.1
Amortization of deferred financing costs and other		0.7		0.6		1.9		1.7
Interest capitalized		(1.3)		(1.1)		(3.4)		(3.3)
Interest on long-term debt	\$	6.0	\$	4.2	\$	16.0	\$	11.5
Interest income	\$	(0.7)	\$	(0.9)	\$	(2.3)	\$	(4.0)
Other interest income, net		(0.5)		(0.4)		(0.9)		(0.4)
Interest income, net	\$	(1.2)	\$	(1.3)	\$	(3.2)	\$	(4.4)
Interest expense, net	\$	4.8	\$	2.9	\$	12.8	\$	7.1

Almost all of the Company's interest income is a result of advances to CVS Leasing Ltd. (CVS). CVS is an entity that owns simulators and other equipment used to train U.K. Ministry of Defense pilots at the Company's Benson Air Force Base training centre. The Company owns a minority shareholding of 14% in CVS. For the nine months ended December 31, 2006, the interest income also included the accretion of discounts on long-term notes receivable settled, in full, during the second quarter of fiscal 2007.

## Note 6: Discontinued Operations

During the third quarter of fiscal 2008, the Company incurred fees, in its discontinued operations, in connection with the evaluation and litigation exercise amounting to \$0.6 million (net of tax recovery of \$0.1 million) in relation to the dispute, currently in arbitration, respecting the payment owed to CAE resulting from the August 2002 sale of substantially all the assets of the sawmill division of its Forestry Systems division.

## Note 7: Capital Stock

(Unaudited) (amounts in millions, except number of shares)	Nine months ended December 31, 2007		Twelve months ended March 31, 2007	
	Number of shares	Stated Value	Number of shares	Stated Value
Balance at beginning of period	251,960,449	\$ 401.7	250,702,430	\$ 389.0
Shares issued <sup>(a)</sup>	169,851	0.8	-	-
Stock options exercised	1,764,995	13.7	1,236,895	10.0
Transfer of contributed surplus upon exercise of stock options	-	2.1	-	2.5
Stock dividends	18,305	0.2	21,124	0.2
Balance at end of period	253,913,600	\$ 418.5	251,960,449	\$ 401.7

<sup>(a)</sup> During the third quarter of fiscal 2008, the Company issued 169,851 common shares at a price of \$4.71 per share for the fourth and final tranche payment for the purchase of the company now called CAE Professional Services (Canada) Inc.

## Note 8: Accumulated Other Comprehensive Loss

The following table provides the components of accumulated other comprehensive loss as disclosed in the consolidated balance sheets:

(Unaudited) (amounts in millions)	Foreign Currency Translation Adjustment	Cash Flow Hedge	Accumulated Other Comprehensive Loss
Foreign currency translation adjustment reclassification	\$ (87.7)	\$ -	\$ (87.7)
Transition adjustments - Financial instruments (Note 2)	-	(3.5)	(3.5)
Balance in accumulated other comprehensive loss on April 1, 2007	\$ (87.7)	\$ (3.5)	\$ (91.2)
Details of other comprehensive income (loss):			
Net change in (losses) gains	(96.9)	24.9	(72.0)
Income tax adjustment	0.6	(8.0)	(7.4)
Total other comprehensive loss for the nine months ended December 31, 2007	\$ (96.3)	\$ 16.9	\$ (79.4)
Balance in accumulated other comprehensive loss as at December 31, 2007	\$ (184.0)	\$ 13.4	\$ (170.6)

## Note 9: Supplementary Information

(Unaudited) (amounts in millions)	Three months ended December 31		Nine months ended December 31	
	2007	2006	2007	2006
Cash provided by (used in) non-cash working capital:				
Accounts receivable	\$ 3.6	\$ 5.4	\$ (7.6)	\$ (25.5)
Inventories	(15.3)	5.5	(9.5)	(21.5)
Prepaid expenses	(7.9)	3.1	(7.8)	1.1
Income taxes recoverable	(8.2)	5.2	(21.1)	-
Accounts payable and accrued liabilities	(23.1)	6.9	(70.7)	3.9
Deposits on contracts	27.2	(8.0)	27.8	15.5
Changes in non-cash working capital	\$ (23.7)	\$ 18.1	\$ (88.9)	\$ (26.5)
Supplemental cash flow disclosure:				
Interest paid	\$ 7.9	\$ 8.4	\$ 19.1	\$ 14.8
Income taxes paid, net	\$ 1.7	\$ (4.4)	\$ 22.9	\$ 2.3
Supplemental statement of earnings disclosure:				
Foreign exchange gain (loss)	\$ 3.4	\$ 1.5	\$ (0.3)	\$ 3.5

### Proceeds from disposal of discontinued operations

The net cash outflows regarding the proceeds from disposal of discontinued operations, as reported in the Consolidated Statements of Cash Flows for the nine months ended December 31, 2006, are composed of a cash payment to L-3 in the amount of \$10.2 million for the net working capital adjustment of the Marine Controls segment, offset, in part, by a cash receipt of \$3.6 million from the sale of a portion of the aggregate land and building, which was previously classified as being held for sale.

## Note 10: Government Cost Sharing

### Project Phoenix

The following table provides information regarding contributions recognized and amounts not yet received for the aggregate project as at December 31, 2007:

(Unaudited) (amounts in millions)	Three months ended December 31, 2007	Nine months ended December 31, 2007
Outstanding contribution receivable, beginning of period	\$ 28.9	\$ 18.4
Contributions	16.7	45.8
Payments received	(23.9)	(42.5)
Outstanding contribution receivable, end of period	\$ 21.7	\$ 21.7

### **Aggregate information about programs**

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

(Unaudited) (amounts in millions)	Three months ended December 31		Nine months ended December 31	
	2007	2006	2007	2006
Contributions credited to capitalized costs:				
Project Phoenix	\$ 5.4	\$ 1.5	\$ 16.4	\$ 5.2
Previous programs	-	-	-	-
Contributions credited to income:				
Project Phoenix	11.3	14.2	29.4	33.9
Previous programs	-	-	-	-
Total contributions:				
Project Phoenix	\$ 16.7	\$ 15.7	\$ 45.8	\$ 39.1
Previous programs	-	-	-	-
Royalty expenses:				
Project Phoenix	\$ -	\$ -	\$ -	\$ -
Previous programs	2.2	2.0	6.4	5.5

The Company recognizes a liability to repay these contributions when the conditions requiring such repayment are met. The repayment is reflected in the consolidated statements of earnings when royalties become due. As at December 31, 2007, the Company's recognized liabilities, in relation to future repayments of the aggregate R&D programs, amounted to \$6.4 million.

### **Note 11: Employee Future Benefits**

The total benefit cost for the periods ended December 31 includes the following components:

(Unaudited) (amounts in millions)	Three months ended December 31		Nine months ended December 31	
	2007	2006	2007	2006
Current service cost	\$ 2.1	\$ 2.1	\$ 6.3	\$ 6.2
Interest cost on projected pension obligations	3.2	2.8	9.5	8.4
Expected return on plan assets	(3.2)	(2.8)	(9.4)	(8.2)
Amortization of net actuarial loss	0.5	0.6	1.6	1.6
Amortization of past service costs	0.2	0.1	0.4	0.4
Net pension expense	\$ 2.8	\$ 2.8	\$ 8.4	\$ 8.4

## Note 12: Operating Segments and Geographic Information

### Results by Segment

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

(Unaudited) three months ended December 31 (amounts in millions)	Simulation Products		Training & Services		Total	
	2007	2006	2007	2006	2007	2006
<b>Civil</b>						
External revenue	\$ 103.5	\$ 92.1	\$ 92.8	\$ 83.1	\$ 196.3	\$ 175.2
Segment Operating Income	25.2	15.5	15.5	13.5	40.7	29.0
Depreciation and amortization						
• Property, plant and equipment	1.2	1.5	11.3	10.1	12.5	11.6
• Intangible and other assets	0.4	0.8	1.2	1.7	1.6	2.5
Capital expenditures	1.2	0.9	14.1	32.5	15.3	33.4
<b>Military</b>						
External revenue	\$ 89.6	\$ 105.2	\$ 58.9	\$ 50.8	\$ 148.5	\$ 156.0
Segment Operating Income	11.5	11.2	9.5	6.8	21.0	18.0
Depreciation and amortization						
• Property, plant and equipment	1.5	1.6	1.3	1.1	2.8	2.7
• Intangible and other assets	1.5	0.3	1.1	0.6	2.6	0.9
Capital expenditures	1.5	1.5	4.3	7.8	5.8	9.3
<b>Total</b>						
External revenue	\$ 193.1	\$ 197.3	\$ 151.7	\$ 133.9	\$ 344.8	\$ 331.2
Segment Operating Income	36.7	26.7	25.0	20.3	61.7	47.0
Depreciation and amortization						
• Property, plant and equipment	2.7	3.1	12.6	11.2	15.3	14.3
• Intangible and other assets	1.9	1.1	2.3	2.3	4.2	3.4
Capital expenditures	2.7	2.4	18.4	40.3	21.1	42.7

(Unaudited) nine months ended December 31 (amounts in millions)	Simulation Products		Training & Services		Total	
	2007	2006	2007	2006	2007	2006
<b>Civil</b>						
External revenue	\$ 328.8	\$ 250.5	\$ 277.6	\$ 245.2	\$ 606.4	\$ 495.7
Segment Operating Income	71.1	45.1	49.7	43.0	120.8	88.1
Depreciation and amortization						
• Property, plant and equipment	3.5	4.2	33.4	28.4	36.9	32.6
• Intangible and other assets	1.6	2.3	5.7	4.7	7.3	7.0
Capital expenditures	3.4	12.6	120.2	80.4	123.6	93.0
<b>Military</b>						
External revenue	\$ 282.2	\$ 265.3	\$ 168.4	\$ 152.4	\$ 450.6	\$ 417.7
Segment Operating Income	37.2	29.6	23.8	27.6	61.0	57.2
Depreciation and amortization						
• Property, plant and equipment	4.4	4.7	4.2	3.1	8.6	7.8
• Intangible and other assets	3.3	1.7	2.1	1.9	5.4	3.6
Capital expenditures	5.2	3.7	12.4	27.6	17.6	31.3
<b>Total</b>						
External revenue	\$ 611.0	\$ 515.8	\$ 446.0	\$ 397.6	\$ 1,057.0	\$ 913.4
Segment Operating Income	108.3	74.7	73.5	70.6	181.8	145.3
Depreciation and amortization						
• Property, plant and equipment	7.9	8.9	37.6	31.5	45.5	40.4
• Intangible and other assets	4.9	4.0	7.8	6.6	12.7	10.6
Capital expenditures	8.6	16.3	132.6	108.0	141.2	124.3

### Earnings before interest and income taxes

The following table provides reconciliation between total Segment Operating Income and earnings before interest and income taxes:

(Unaudited) (amounts in millions)	Three months ended December 31		Nine months ended December 31	
	2007	2006	2007	2006
Total Segment Operating Income	\$ 61.7	\$ 47.0	\$ 181.8	\$ 145.3
Restructuring charge	-	(2.3)	-	(2.7)
Other costs associated with the Restructuring Plan <sup>(a)</sup>	-	(0.5)	-	(6.5)
Earnings before interest and income taxes	\$ 61.7	\$ 44.2	\$ 181.8	\$ 136.1

<sup>(a)</sup> In the past, the Company incurred costs, which were excluded from the determination of Segment Operating Income, related to the re-engineering of the Company's business processes including a component associated with the first phase of the deployment of the ERP system. As at April 1, 2007, the costs related with the first phase of the ERP deployment have ended. Current costs associated with additional phases of the deployment of the ERP system are not considered restructuring costs and will be included in the determination of Segment Operating Income.

### Assets Employed by Segment

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

(Unaudited) (amounts in millions)	As at December 31	As at March 31
	2007	2007
Simulation Products/Civil	\$ 209.2	\$ 188.0
Simulation Products/Military	295.3	251.2
Training & Services/Civil	969.7	973.8
Training & Services/Military	207.7	208.7
<b>Total assets employed</b>	<b>\$ 1,681.9</b>	<b>\$ 1,621.7</b>
Assets not included in assets employed	388.5	334.5
<b>Total assets</b>	<b>\$ 2,070.4</b>	<b>\$ 1,956.2</b>

## Geographic Information

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

<i>(Unaudited)</i> <i>(amounts in millions)</i>	Three months ended December 31		Nine months ended December 31	
	2007	2006	2007	2006
Revenue from external customers				
Canada	\$ 11.7	\$ 42.9	\$ 78.2	\$ 103.0
United States	104.8	100.1	323.7	276.8
United Kingdom	23.9	29.5	77.9	72.8
Germany	42.8	47.8	118.0	127.3
Netherlands	21.0	19.8	80.4	70.7
Other European countries	34.4	45.8	111.6	85.0
China	25.5	14.9	55.8	42.6
United Arab Emirates	19.6	4.4	44.0	24.1
Other Asian countries	24.4	3.4	61.0	49.3
Other countries	36.7	22.6	106.4	61.8
	<b>\$ 344.8</b>	<b>\$ 331.2</b>	<b>\$ 1,057.0</b>	<b>\$ 913.4</b>

<i>(Unaudited)</i> <i>(amounts in millions)</i>	As at December 31	As at March 31
	2007	2007
Property, plant and equipment, goodwill and intangible assets		
Canada	\$ 208.6	\$ 145.5
United States	273.9	290.1
South America	55.3	55.5
United Kingdom	140.1	142.8
Spain	84.2	89.9
Germany	57.6	53.3
Netherlands	117.5	140.8
Other European countries	58.7	62.7
United Arab Emirates	63.5	72.8
Asia	47.3	44.1
Other countries	11.5	22.0
	<b>\$ 1,118.2</b>	<b>\$ 1,119.5</b>