

CAE INC  
Form 6-K  
November 17, 2008

**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, DC 20549**

**Form 6-K**

Report of Foreign Issuer  
Pursuant to Rule 13a-16 or 15d-16 of  
the Securities Exchange Act of 1934

For the month of: November, 2008

Commission File Number: 1-31402

**CAE INC.**

(Name of Registrant)

**8585 Cote de Liesse**  
**Saint-Laurent, Quebec**  
**Canada H4T 1G6**

(Address of Principal Executive Offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

Form 20-F

Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the SEC pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

Yes

No

If  Yes is marked, indicate the file number assigned to the registrant in connection with Rule 12g3-2(b): N/A

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**CAE Inc.**

Date: November 14, 2008

By: /s/ Hartland Paterson  
Name: Hartland J. Paterson  
Title: Vice President Legal, General Counsel  
and Corporate Secretary

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## Report to Shareholders

CAE reported financial results for the second quarter ended September 30, 2008. Earnings from continuing operations were \$48.9 million (\$0.19 per share) this quarter, compared to \$39.0 million (\$0.15 per share) in the second quarter of last year. All financial information is in Canadian dollars.

### Summary of consolidated results

Consolidated revenue this quarter was \$406.7 million compared to \$353.9 million in the second quarter last year.

Net earnings, including the impact of discontinued operations, were \$48.7 million in the second quarter.

Second quarter consolidated earnings before interest and taxes (EBIT) were \$75.5 million, or 18.6% of revenue compared to \$62.1 million or 17.5% of revenue last year.

Robert E. Brown, CEO, announced the appointment of Marc Parent as Executive Vice President and Chief Operating Officer, effective immediately. Mr. Parent also becomes a member of CAE's Board of Directors. Mr. Parent's mandate is to ensure the building of synergies between all four of CAE's civil and military business segments. Jeff Roberts remains in his position as Group President, Innovation and Civil Training and Services.

We had good performance in the second quarter with overall revenue and earnings growth supported by free cash flow, said Robert E. Brown, CAE's President and Chief Executive Officer. Our strategic imperative to strengthen CAE with a solid financial base is proving more relevant in the current economic environment. We have the advantage of a conservative capital structure, which gives us a good degree of flexibility. Combined with the benefits of our geographic diversification, the split between civil and military markets and the balance between products and services, we believe CAE remains well positioned for the future. We continue to see opportunities for growth in most of our core markets as well as our adjacent markets.

### Business segment highlights

During the second quarter, Training and Services/Civil won \$78.8 million in contracts and had an average of 118 RSEUs (Revenue Simulator Equivalent Units). We signed contracts with many companies including Kingfisher and Air Malta. As well, we were selected by XOJET to provide initial training for its new fleet of Bombardier Challenger 300 aircraft. We commenced training programs according to the global training network expansion which was announced in September 2007.

In Simulation Products/Civil we won orders for 7 full-flight simulators (FFSs) during the quarter. Year to date, we have announced 23 FFS sales. Based on forecast aircraft deliveries and despite current market conditions, we continue to expect to receive approximately 34 orders for the year as a whole. As we have done in the past, we intend to update this estimate as the year progresses.

We were awarded a number of new military contracts this quarter totalling \$227.1 million. In Simulation Products/Military, they include a contract by the United States Navy for the design and manufacture of an MH-60R tactical operational flight trainer, upgrades to the Chinook full-mission simulator used in training by the U.K. Royal Air Force in Benson, and contracts by the Netherlands Ministry of Defence for comprehensive NH90 helicopter training systems and services awarded to Rotorsim, the consortium owned equally by CAE and AgustaWestland. In Training and Services/Military we received a series of contracts which include a ten-year contract to provide management, maintenance and support services for the Australian Air Force's MRH-90 FFSs, additional training services to the Ministry of Defence in the U.K., and maintenance services for the Italian Air Force's C-130J simulator.

### Civil segments

#### *Training & Services/Civil (TS/C)*

For the second quarter, revenue in the TS/C segment increased 20% over the same period last year due mainly to the contribution of additional RSEUs into our network combined with the integration into our results of two acquired companies, Sabena Flight Academy and Flightscape.

Segment operating income was \$19.1 million (17.7% of revenue) in the second quarter, up 31% year over year. This was mainly due to the increase in revenue and the realization of cost savings from the successful integration of a venture, partially offset by

costs associated with the expansion of our network.

New orders totalled \$78.8 million, and segment backlog was \$907.6 million. The book-to-sales ratio was 0.73x for the quarter and 0.94x for the last 12 months.

## Report to Shareholders

### *Simulation Products/Civil (SP/C)*

Revenue in the SP/C segment was \$114.3 million, up 2% over last year; the increase was mainly attributed to a higher number of orders since the beginning of fiscal year 2009.

Segment operating income was \$23.4 million (20.5% of revenue) in the second quarter, down by 11% over last year mainly due to the impact of less beneficial hedging rates on revenues compared to the same quarter last year. As well, we had a higher utilization of funds from our government cost sharing programs last year.

During the quarter, we received orders for 7 civil FFSs. Orders totalled \$83.9 million, and segment backlog was \$343.4 million. The book-to-sales ratio was 0.73x for the quarter and 0.96x for the last 12 months.

### **Military segments**

Combined revenue in the second quarter for the Military business as a whole was \$184.4 million and combined operating income was \$33.0 million, resulting in an operating margin of 17.9% ..

Combined new orders totalled \$227.1 million and the combined book-to-sales ratio was 1.23x for the quarter and 1.45x for the last 12 months.

### *Simulation Products/Military (SP/M)*

Revenue in the SP/M segment was \$126.0 million for the second quarter, compared with \$97.1 million generated during the same period last year. The 30% increase was mainly due to higher activity on recently awarded contracts, including the Australian and Netherlands NH90 programs, the Netherlands C-130 and KDC-10 programs and Singapore's Super Puma program.

Segment operating income this quarter was \$21.6 million (17.1% of revenue), up 61% year over year. The increase was mainly due to the increase in volume.

New orders for the quarter totalled \$112.6 million and segment backlog was \$705.6 million.

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

Revenue in the TS/M segment was \$58.4 million for the second quarter, up by 7% over the same period last year. The increase is mainly a result of an increased demand for training in our helicopter training centre in Benson, U.K., as well as an increased level of effort on some of our maintenance services contracts on various German military bases and increased C-130 and Predator services to the U.S. Air Force.

Segment operating income was \$11.4 million this quarter, up 44% from the same period last year. This increase results mainly from higher revenue.

New orders this quarter totalled \$114.5 million and segment backlog was \$785.2 million.

### **Cash flow and financial position**

Free cash flow was \$43.2 million for the second quarter, up \$7.9 million year over year. The increase year over year was mainly due to lower maintenance capital expenditures. This was offset by net cash provided by continuing operations decreasing by \$38.3 million, explained largely by higher investment in non-cash working capital, as well as additional cash dividends issued this quarter. Last year, maintenance capital expenditures included the buyback of some leased simulators that were already part of our network.

Net debt was \$256.5 million at September 30, 2008, up \$2.0 million from the preceding quarter.

CAE will pay a dividend of \$0.03 per share on December 31, 2008 to shareholders of record at the close of business on December 12, 2008.





Report to Shareholders

**Additional consolidated financial results**

*Backlog*

Our consolidated backlog was \$2.742 billion at the end of this quarter. New orders of \$389.8 million were added to backlog this quarter, offset by \$406.7 million in revenue generated from backlog and a decrease of \$89.2 million mainly caused by foreign exchange fluctuations.

*Capital expenditures*

Capital expenditures this quarter totalled \$50.6 million and were higher this quarter than last quarter mainly due to the ongoing investment to expand the training network to address additional market share and were in response to increased training demands in new markets.

*Income taxes*

Income taxes were \$21.4 million this quarter, representing an effective tax rate of 30%. We expect the effective income tax rate for fiscal 2009 to remain approximately 30%.

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# Management's Discussion and Analysis

for the six months ended September 30, 2008

## 1. HIGHLIGHTS

### FINANCIAL

#### SECOND QUARTER OF FISCAL 2009

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

- Consolidated revenue was \$406.7 million this quarter, \$14.6 million higher than last quarter and \$52.8 million or 15% higher than the same quarter last year;
- For the first six months of fiscal 2009, consolidated revenue was \$798.8 million, \$86.6 million or 12% higher than the same period last year.

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

- Earnings from continuing operations were \$48.9 million (or \$0.19 per share) this quarter, compared to \$47.0 million (or \$0.18 per share) last quarter, and \$39.0 million (or \$0.15 per share) in the second quarter of last year, representing an increase of \$9.9 million or 25%;
- For the first six months of fiscal 2009, earnings from continuing operations were \$95.9 million (or \$0.38 per share) compared to \$77.7 million (or \$0.31 per share) for the same period last year, a 23% increase.

##### Positive free cash flow<sup>1</sup> at \$43.2 million

- Net cash provided by continuing operations was \$59.4 million this quarter, compared to a negative \$28.7 million last quarter and \$97.7 million in the second quarter of last year;
- Maintenance capital expenditures<sup>2</sup> and other assets were \$8.7 million this quarter, compared to \$6.6 million last quarter and \$59.9 million in the second quarter of last year;
- Cash dividends were \$7.5 million this quarter, compared to \$7.1 million last quarter and \$2.5 million in the second quarter of last year.

##### Capital employed<sup>3</sup> increased by 2% or \$27.5 million this quarter

- Non-cash working capital<sup>4</sup> increased by \$10.3 million this quarter, ending at negative \$22.5 million;
- Net debt<sup>5</sup> ended this quarter at \$256.5 million.

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

- The book-to-sales ratio for the quarter was 0.96x. The ratio for the last 12 months was 1.16x;
- Total order intake was \$389.8 million, compared to \$356.9 million last quarter and \$353.8 million in the second quarter of last year;
- Total backlog was \$2,741.8 million as at September 30, 2008.

#### Civil segments

- Training & Services/Civil won \$79 million in contracts;
- Simulation Products/Civil won over \$83 million of orders including 7 full-flight simulators (FFSs).

#### Military segments

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- Simulation Products/Military won over \$112 million of orders for new training systems and upgrades;
- Training & Services/Military won contracts valued at over \$114 million.

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

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

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

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

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

<sup>6</sup> Non-GAAP measure (see Section 5.2) .

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Management's Discussion and Analysis

**2. INTRODUCTION**

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

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

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

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

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

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

**ABOUT MATERIAL INFORMATION**

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

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

**ABOUT FORWARD-LOOKING STATEMENTS**

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

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

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

**3. ABOUT CAE**

**3.1 Who we are**

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

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

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## Management's Discussion and Analysis

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

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

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

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

### 3.2 Our vision

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

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

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

### 3.3 Our operations

CAE serves two markets globally:

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

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

#### **CIVIL MARKET**

##### **Training & Services/Civil (TS/C)**

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

Our TS/C segment is the second largest provider of civil aviation training services in the world and serves all sectors of the market including general aviation, regional airlines, commercial airlines and business aviation. We also offer a full range of technical services, such as training centre management, aircraft maintenance training services, simulator spare parts inventory management, curriculum development, consulting services and e-Learning solutions. We achieved our leading position through acquisitions, joint ventures and organically growing new facilities. We currently have more than 130 FFSs in operation. We provide aviation training and services in more than 30 locations around the world, including aviation training centres, flight training organizations (FTOs) and third party locations. We intend to increase the number of revenue simulator equivalent units (RSEUs) in our network to maintain our position and address new market opportunities. We are developing our training network primarily to meet the long-term, steady stream of recurring training needs so that as a company, we continue to become less dependent on new aircraft deliveries to drive revenue.

##### **Simulation Products/Civil (SP/C)**

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

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

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## Management's Discussion and Analysis

### Market trends and outlook

Our outlook for the civil market is cautiously optimistic. Our training services revenue comes primarily from recurrent training that is essential to support the existing global in-service aircraft fleet which totals over 33,000 aircraft. In the products segment, our revenue comes mainly from orders in backlog. We enjoy a solid base of business but the current high degree of economic and market uncertainty warrants a degree of additional restraint as our customers respond to these rapidly evolving conditions. We believe that over the long-term the aerospace business, and more specifically the training products and services segments, will continue to experience growth as a result of the positive secular trends in global air travel. We are monitoring key economic and market factors that could impact our business and potentially change our outlook. Most notably, the disruption in global financial and credit markets has the potential to impact a number of CAE's customers. As well, the recent decreases in global passenger traffic need to be followed for any potential longer term implications that could impact future sales.

The following trends support our view for the civil market:

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

The impact of the current global economic slowdown is most acute in mature markets like the U.S. and Europe. Conditions in emerging markets have slowed as well from their previous robust pace but remain relatively stronger. We are monitoring a number of factors which could constrain growth in the broader global market: volatile prices of jet fuel, which has an impact on airline profitability and potential refueling; the possibility of a protracted economic recession in the U.S and around the world; the merger of airlines leading to fleet and route rationalization; and the availability of credit resources for our customers given the ongoing disruption of the credit markets. However, we expect that over the long-term, global economic growth will continue to support demand for air travel.

#### ***Large aircraft backlogs***

In calendar 2007, Boeing received a total of 1,413 net orders for new aircraft and Airbus received a total of 1,341 orders. As of September 30, 2008, new aircraft orders for Boeing and Airbus were 623 and 785 respectively. While the pace of order activity is slowing in calendar 2008, and more recently there have been press reports of aircraft delivery deferrals by some of their customers, their record backlog levels and steady production of narrow body models are expected to help generate opportunities for our full portfolio of training products and services. These two OEMs have announced customer financing programs.

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

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

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

#### ***Demand in emerging markets arising from secular growth***

##### *New and emerging markets*

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



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

While passenger traffic growth is slowing from the strong growth in calendar year 2007, we anticipate that passenger traffic will grow in the long-term. Currently, air transport is in a highly dynamic period with challenges such as a slowing world economy and volatile oil prices. This has led to slowing traffic growth in some markets. However, 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

## Management's Discussion and Analysis

include major disruptions like regional political instability, acts of terrorism, pandemics, a sharp and sustained increase in fuel costs, major 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 impacting aging demographics, fewer military pilots transferring to civil airlines, and low enrolment in technical schools. Emerging markets like Southeast Asia and China are experiencing this even more severely because air traffic is growing at a more rapid pace than in developed countries, and the infrastructure available to meet the current and projected demand for crew members is lacking.

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

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

*New pilot certification process requires simulation-based training*

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

## **MILITARY MARKET**

### **Simulation Products/Military (SP/M)**

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

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

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

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

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

## **Market trends and outlook**

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

- Demand for our type of specialized products and services is growing;
- High cost of operating live assets for training is leading militaries to employ more simulation;
- The nature of warfare has changed.

***Demand for our type of specialized products and services is growing***

*New aircraft platforms*

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

### Management's Discussion and Analysis

marketing the C-295 transport aircraft worldwide, and Sikorsky is offering new models of its H-60 helicopter to armies and navies worldwide, all of which fuel the demand for new simulators and training.

#### *Trend towards outsourcing*

With finite defence budgets and resources, defence forces and governments continue to scrutinize expenditures to find ways to save money and allow active-duty personnel to focus on operational requirements. There has been a growing trend among defence forces to outsource a variety of training services and we expect this trend to continue. Governments are outsourcing training services because they can be delivered more quickly and more cost-effectively. For example, CAE is part of a consortium that has begun offering NH90 training to Germany and other militaries in 2009.

#### *Extension and upgrade of existing weapon system platforms*

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

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

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

#### ***The nature of warfare has changed***

##### *Demand for networking*

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

##### *Growing acceptance of synthetic training for mission rehearsal*

There is a growing trend among defence forces to use synthetic training to meet more of their training requirements. Synthetic environment software allows defence clients to plan sophisticated missions and carry out full mission rehearsals as a complement to traditional live training or mission preparation. Synthetic training offers militaries a cost-effective way to provide realistic training for a wide variety of scenarios while ensuring they maintain a high state of readiness. For example, over the past year we have delivered MH-47G and MH-60L combat mission simulators to the U.S. Army's 16<sup>th</sup> Special Operations Aviation Regiment that feature the CAE-developed Common Database (CDB). The CDB promises to significantly enhance rapid simulation-based mission rehearsal capabilities.

## 4. FOREIGN EXCHANGE

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

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

## Management's Discussion and Analysis

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</b>	June 30	Increase	March 31	Increase
	<b>2008</b>	2008	(decrease)	2008	(decrease)
U.S. dollar (US\$ or USD)	<b>1.0599</b>	1.0186	4%	1.0279	3%
Euro ( € )	<b>1.4923</b>	1.6041	(7%)	1.6244	(8%)
British pound (£ or GBP)	<b>1.8868</b>	2.0276	(7%)	2.0407	(8%)

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

	<b>September 30</b>	June 30	Increase	September 30	Increase
	<b>2008</b>	2008	(decrease)	2007	(decrease)
U.S. dollar (US\$ or USD)	<b>1.0393</b>	1.0106	3%	1.0443	
Euro ( € )	<b>1.5631</b>	1.5802	(1%)	1.4365	9%
British pound (£ or GBP)	<b>1.9679</b>	1.9929	(1%)	2.1115	(7%)

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

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

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

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

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

- **Our simulation products operations in Canada**

Although the net assets of our Canadian operations are not exposed to changes in the value of foreign currencies (except for receivables and payables in foreign currencies), approximately 85% of our annual revenue generated from Canada is in foreign currencies (mostly the U.S. dollar and euro), while a significant portion of our expenses are in Canadian dollars. We generally hedge the milestone payments in sales contracts denominated in foreign currencies to protect ourselves from some of the foreign exchange exposure. Since less than 100% of our revenues are hedged, it is not possible to completely offset the effects of changing foreign currency values, leaving some residual exposure that can affect the statement of earnings.

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

During the second quarter of fiscal 2009, we began to create a portfolio of currency hedging positions intended to mitigate the risk to a portion of future revenues presented by the current high-level volatility of the Canadian dollar versus the U.S. currency. With respect to the remaining expected future revenues, our manufacturing operations in Canada remain exposed to changes in the value of the Canadian dollar.



## Management's Discussion and Analysis

## 5. CONSOLIDATED RESULTS

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

## Summary of consolidated results

<i>(amounts in millions, except per share amounts)</i>	Q2-2009	Q1-2009	Q4-2008	Q3-2008	Q2-2008
Revenue	\$ 406.7	392.1	366.6	344.8	353.9
Earnings before interest and income taxes (EBIT)	\$ 75.5	71.3	69.7	61.7	62.1
<i>As a % of revenue</i>	% 18.6	18.2	19.0	17.9	17.5
Interest expense, net	\$ 5.2	4.3	4.7	4.8	5.4
Earnings from continuing operations (before taxes)	\$ 70.3	67.0	65.0	56.9	56.7
Income tax expense	\$ 21.4	20.0	18.0	16.8	17.7
Earnings from continuing operations	\$ 48.9	47.0	47.0	40.1	39.0
Results from discontinued operations	\$ (0.2)	(0.9)	(11.4)	(0.6)	(0.1)
Net earnings	\$ 48.7	46.1	35.6	39.5	38.9
Basic EPS from continuing operations	\$ 0.19	0.18	0.19	0.16	0.15
Diluted EPS from continuing operations	\$ 0.19	0.18	0.18	0.16	0.15
Basic and diluted EPS	\$ 0.19	0.18	0.14	0.16	0.15

## Revenue was 4% higher than last quarter and 15% higher year over year

Revenue was \$14.6 million higher than last quarter mainly because:

- SP/M's revenue increased by \$37.6 million, or 43%, mainly due to higher activity on recently awarded contracts including the Australian and Netherlands NH90 programs, the Netherlands C-130 and KDC-10 programs and Singapore's Super Puma program;
- TS/M's revenue increased by \$1.5 million, or 3%, mainly due to an increased demand for training in our helicopter training centre in Benson, U.K.

These increases were offset by the decrease in SP/C's revenue of \$22.3 million, or 16%, mainly due to a higher number of orders and revenue recognized during the first quarter on simulators that were being manufactured and near completion for which sales contracts were obtained during the first quarter, as well as the decrease in TS/C's revenue of \$2.2 million, or 2%, mainly due to seasonal fluctuations.

Revenue was \$52.8 million higher than the same period last year largely because:

- SP/M's revenue increased by \$28.9 million, or 30%, due to the above-mentioned quarterly comparative reasons;
- TS/C's revenue increased by \$18.0 million, or 20%, mainly due to the integration into our results of Sabena Flight Academy and Flightscape Inc., two acquired companies, combined with the contribution of additional RSEUs into our network and a better performance of our flight school in Europe;
- TS/M's revenue increased by \$3.9 million, or 7%, due to the above-mentioned quarterly comparative reasons, as well as an increased level of effort on some of our maintenance services contracts on various German military bases and increased C-130 and Predator services to the U.S. Air Force;
- SP/C's revenue increased by \$2.0 million, or 2%, mainly due to a higher number of orders since the beginning of fiscal year 2009.

Revenue year to date of \$798.8 million was \$86.6 million, or 12%, higher than the first six months of fiscal 2008.

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

## Management's Discussion and Analysis

### **EBIT<sup>7</sup> was \$4.2 million higher than last quarter and \$13.4 million higher year over year**

EBIT for this quarter was \$75.5 million, or 18.6% of revenue.

Compared to the last quarter, EBIT was up by \$4.2 million, or 6%. Increased segment operating income<sup>8</sup> from the SP/M and TS/M segments were partly offset by a decrease in the SP/C and TS/C segments.

Year over year, EBIT was up by \$13.4 million, or 22%, mainly because of higher segment operating income of \$8.2 million for SP/M, \$3.5 million for TS/M and \$4.5 million for TS/C. The increase was partially offset by a decrease of \$2.8 million for the SP/C segment.

For the first six months of the year, EBIT was \$146.8 million, which is \$26.7 million or 22% higher than for the same period last year.

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

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

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

For the first six months of the year, net interest expense was \$9.5 million, which is \$1.5 million higher than the same period last year. This was mainly because of higher interest expense on long-term debt attributed to higher debt levels, offset by higher capitalized interest on assets under construction.

### **Effective income tax rate is 30% this quarter**

Income taxes this quarter were \$21.4 million, representing an effective tax rate of 30%, similar to last quarter and compared to 31% for the second quarter of fiscal 2008. Income taxes for the first six months were \$41.4 million, representing an effective tax rate of 30%, compared to 31% for the same period last year.

The tax rate was lower this quarter and for the first six months of fiscal 2009 because of changes in the mix of income from various jurisdictions for tax purposes.

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

### **Results from discontinued operations**

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

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

Our consolidated backlog was \$2,741.8 million at the end of this quarter. New orders of \$389.8 million were added to backlog this quarter, offset by \$406.7 million in revenue generated from backlog and a decrease of \$89.2 million mainly caused by the appreciation of the Canadian dollar against the British pound and the euro, partly offset by the depreciation of the Canadian dollar against the U.S. dollar.

<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.



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

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

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

**Backlog down by 4% over last quarter mainly due to foreign currency impact**

<i>(amounts in millions)</i>	Three months ended September 30, 2008	Six months ended September 30, 2008
Backlog, beginning of period	\$ 2,847.9	\$ 2,899.9
+ orders	389.8	746.7
- revenue	(406.7)	(798.8)
+ / - adjustments (mainly FX)	(89.2)	(106.0)
Backlog, end of period	\$ 2,741.8	\$ 2,741.8

The book-to-sales ratio for the quarter was 0.96x. The ratio for the last 12 months was 1.16x.

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

**6. RESULTS BY SEGMENT**

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

Civil segments:

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

Military segments:

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

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

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

**KEY PERFORMANCE INDICATORS****Segment operating income**

<i>(amounts in millions, except operating margins)</i>		<b>Q2-2009</b>	Q1-2009	Q4-2008	Q3-2008	Q2-2008
<i>Civil segments</i>						
Training & Services/Civil	\$	<b>19.1</b>	20.7	23.8	15.5	14.6
	%	<b>17.7</b>	18.8	22.8	16.7	16.2
Simulation Products/Civil	\$	<b>23.4</b>	27.4	23.8	25.2	26.2
	%	<b>20.5</b>	20.1	22.3	24.3	23.3
<i>Military segments</i>						
Simulation Products/Military	\$	<b>21.6</b>	13.6	14.5	11.5	13.4
	%	<b>17.1</b>	15.4	14.3	12.8	13.8
Training & Services/Military	\$	<b>11.4</b>	9.6	7.6	9.5	7.9
	%	<b>19.5</b>	16.9	14.0	16.1	14.5
Total segment operating income (EBIT)	\$	<b>75.5</b>	71.3	69.7	61.7	62.1

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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.

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## Management's Discussion and Analysis

**Capital employed***(amounts in millions)*

	<b>Q2-2009</b>	Q1-2009	Q4-2008	Q3-2008	Q2-2008
<i>Civil segments</i>					
Training & Services/Civil	\$ <b>939.1</b>	919.0	868.3	774.3	762.5
Simulation Products/Civil	\$ <b>(20.9)</b>	(12.5)	(81.9)	(38.7)	(26.9)
<i>Military segments</i>					
Simulation Products/Military	\$ <b>139.2</b>	106.7	68.4	100.1	98.1
Training & Services/Military	\$ <b>146.6</b>	150.5	136.5	138.4	135.8
	\$ <b>1,204.0</b>	1,163.7	991.3	974.1	969.5

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

TS/C won \$78.8 million in contracts this quarter including:

- Signed a two-year contract with Kingfisher to provide wet and dry training on the ATR72-500 in Brussels, Belgium;
- Signed a three-year contract with Air Malta to provide wet and dry training on the A320 in Burgess Hill, U.K.;
- Selected by XOJET to provide initial training for its new fleet of Bombardier Challenger 300 aircraft, which recently entered into service, at our business aviation training centre in Morristown, New Jersey. A new Challenger 300 full-flight simulator is scheduled to enter into service at the centre later this year to support XOJET's initial training as well as CAE's Authorized Training Provider agreement with Bombardier.

**Expansion and new initiatives**

- We combined and consolidated the Joint Aviation Authorities (JAA) certification of five of our worldwide training centres under one global JAA operating certificate thus ensuring a smoother regulatory transition for our clients across our global network. Our long-term plan is to include the remaining four JAA training centres and all future JAA training centres into this global approval network;
- We commenced training programs according to the global training network expansion which was announced in September 2007. Training programs have started at the North East Training Centre for the Hawker 800XP and the Gulfstream G450/550, at the Burgess Hill Training Centre, U.K. for the Global Express and at the Dallas Training Centre, CAE SimuFlite, for the Phenom 100.

**Financial results**

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

	<b>Q2-2009</b>	Q1-2009	Q4-2008	Q3-2008	Q2-2008
Revenue	\$ <b>108.0</b>	110.2	104.5	92.8	90.0
Segment operating income	\$ <b>19.1</b>	20.7	23.8	15.5	14.6
<i>Operating margins</i>	% <b>17.7</b>	18.8	22.8	16.7	16.2
Amortization & depreciation	\$ <b>15.7</b>	13.8	12.9	12.5	13.5
Capital expenditures	\$ <b>42.3</b>	34.2	41.6	14.1	79.3
Capital employed	\$ <b>939.1</b>	919.0	868.3	774.3	762.5
Backlog	\$ <b>907.6</b>	932.7	963.3	896.1	887.5
RSEU <sup>10</sup>	<b>118</b>	114	110	109	106
FFSs deployed	<b>133</b>	132	124	123	119

**Revenue down by 2% over last quarter and up by 20% year over year**

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The decrease over last quarter was attributed to seasonal fluctuations, change in revenue mix and some softening in North America, partially offset by the contribution of our recent acquisition of Sabena Flight Academy and additional RSEUs.

The increase year over year was mainly due to the integration into our results of Sabena Flight Academy and Flightscape Inc., two acquired companies, combined with the contribution of additional RSEUs into our network and a better performance of our flight school in Europe.

Revenue year to date is \$218.2 million, 18% or \$33.4 million higher than the same period last year.

<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.

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## Management's Discussion and Analysis

### Segment operating income down 8% over last quarter and up 31% year over year

Segment operating income was \$19.1 million (17.7% of revenue) this quarter, compared to \$20.7 million (18.8% of revenue) in the last quarter and \$14.6 million (16.2% of revenue) in the same period last year.

Segment operating income decreased by \$1.6 million, or 8%, over last quarter. This was attributed to the above-mentioned decrease in revenue, ramp-up of new devices and integration of Sabena Flight Academy.

Segment operating income increased by \$4.5 million, or 31%, over the same period last year. This was mainly due to the above-mentioned increase in revenue and the realization of cost savings from the successful integration of a venture, partially offset by costs associated with the expansion of our network.

Segment operating income for the first six months of the year was \$39.8 million (18.2% of revenue), 16% or \$5.6 million higher than in the same period last year.

### Capital expenditures at \$42.3 million this quarter

Capital expenditures were higher this quarter than last quarter, mainly due to the ongoing investment to expand the training network to address additional market share, and in response to increased training demands in new markets.

### Capital employed increased by \$20.1 million over last quarter

The increase over last quarter was mainly due to capital investments in our training network. This was partially offset by a reduction in the non-cash working capital over last quarter.

### Backlog was at \$907.6 million at the end of the quarter

<i>(amounts in millions)</i>		Three months ended September 30, 2008		Six months ended September 30, 2008
Backlog, beginning of period	\$	932.7	\$	963.3
+ orders		78.8		167.8
- revenue		(108.0)		(218.2)
+ / - adjustments (mainly FX)		4.1		(5.3)
Backlog, end of period	\$	907.6	\$	907.6

This quarter's book-to-sales ratio was 0.73x. The ratio for the last 12 months was 0.94x.

### SIMULATION PRODUCTS/CIVIL

SP/C was awarded contracts for the following 7 FFSs this quarter:

- One B777 FFS to Etihad Airways;
- One A320 FFS to Flight Simulation Company;
- One B737 FFS to Southwest Airlines;
- One B747-8 FFS to Cathay Pacific Airways;
- One A330-340 FFS to Lufthansa Flight Training GmbH;
- One EMB 170 FFS to Suzuyo & Co.;
- One Phenom 100 FFS 5000 Series to the Embraer CAE Training Services joint venture.

This brings SP/C's total order intake for the year to 20 FFSs.

**Financial results***(amounts in millions, except operating margins)*

	<b>Q2-2009</b>	Q1-2009	Q4-2008	Q3-2008	Q2-2008
Revenue	\$ <b>114.3</b>	136.6	106.5	103.5	112.3
Segment operating income	\$ <b>23.4</b>	27.4	23.8	25.2	26.2
<i>Operating margins</i>	% <b>20.5</b>	20.1	22.3	24.3	23.3
Amortization & depreciation	\$ <b>1.6</b>	1.5	1.8	1.6	2.0
Capital expenditures	\$ <b>1.4</b>	0.6	1.2	1.2	1.4
Capital employed	\$ <b>(20.9)</b>	(12.5)	(81.9)	(38.7)	(26.9)
Backlog	\$ <b>343.4</b>	373.2	381.8	388.7	373.3

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## Management's Discussion and Analysis

### Revenue down by 16% over last quarter and up by 2% year over year

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

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

Revenue year-to-date is \$250.9 million, 11% or \$25.6 million higher than the same period last year.

### Segment operating income down by 15% over last quarter and by 11% year over year

Segment operating income decreased over last quarter mainly as a result of the above-mentioned decrease in revenue.

Segment operating income decreased year over year mainly due to the impact of less beneficial hedging rates on revenue compared to the same quarter last year. As well, we had a higher utilization of funds from our government cost sharing programs last year.

Segment operating income for the first six months of the year was \$50.8 million (20.2% of revenue), 11% or \$4.9 million higher than the same period last year.

### Capital employed decreased by \$8.4 million over last quarter

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

### Backlog down by 8% over last quarter

<i>(amounts in millions)</i>	Three months ended		Six months ended
	September 30, 2008		September 30, 2008
Backlog, beginning of period	\$	373.2	\$ 381.8
+ orders		83.9	213.6
- revenue		(114.3)	(250.9)
+ / - adjustments (mainly FX)		0.6	(1.1)
Backlog, end of period	\$	343.4	\$ 343.4

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

## 6.2 Military segments

### SIMULATION PRODUCTS/MILITARY

SP/M was awarded \$112.6 million in orders this quarter, including:

- One MH-60R tactical operational flight trainer for the U.S. Navy;
- One NH90 full-mission flight trainer and one NH90 virtual sensor trainer for the Netherlands Ministry of Defence, awarded to Rotorsim, a consortium with equal participation between CAE and AgustaWestland;
- Upgrades to the Chinook full-mission simulator used in training by the U.K. Royal Air Force in Benson.

### Financial results

*(amounts in millions, except operating margins)*

	Q2-2009	Q1-2009	Q4-2008	Q3-2008	Q2-2008
Revenue	\$ 126.0	88.4	101.5	89.6	97.1



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Segment operating income	\$	<b>21.6</b>	13.6	14.5	11.5	13.4
<i>Operating margins</i>	%	<b>17.1</b>	15.4	14.3	12.8	13.8
Amortization & depreciation	\$	<b>2.3</b>	2.6	2.8	3.0	2.5
Capital expenditures	\$	<b>1.1</b>	1.2	2.1	1.5	2.4
Capital employed	\$	<b>139.2</b>	106.7	68.4	100.1	98.1
Backlog	\$	<b>705.6</b>	752.6	765.1	704.4	535.3

## Management's Discussion and Analysis

### Revenue up by 43% over last quarter and by 30% year over year

The increase over last quarter and year over year was mainly due to higher activity on recently awarded contracts, including the Australian and Netherlands NH90 programs, the Netherlands C-130 and KDC-10 programs and Singapore's Super Puma program.

Revenue year to date is \$214.4 million, 11% or \$21.8 million higher than the same period last year.

### Segment operating income up by 59% over last quarter and by 61% year over year

The increase over last quarter and year over year was mainly due to the above-mentioned increase in volume, which resulted in an operating margin of 17.1% for SP/M this quarter, compared to 15.4% in the last quarter and 13.8% in the same period last year.

Segment operating income for the first six months of the year was \$35.2 million, 37% or \$9.5 million higher than the same period last year.

### Capital employed increased by \$32.5 million over last quarter

The increase this quarter was mainly because of higher working capital accounts attributed to the above-mentioned increase in revenue.

### Backlog down by 6% over last quarter

<i>(amounts in millions)</i>		Three months ended September 30, 2008		Six months ended September 30, 2008
Backlog, beginning of period	\$	752.6	\$	765.1
+ orders		112.6		189.5
- revenue		(126.0)		(214.4)
+ / - adjustments (mainly FX)		(33.6)		(34.6)
Backlog, end of period	\$	705.6	\$	705.6

This quarter's book-to-sales ratio was 0.89x. The ratio for the last 12 months was 1.47x.

## TRAINING & SERVICES/MILITARY

TS/M was awarded \$114.5 million in orders this quarter, including:

- A ten-year contract to provide management, maintenance and support services for the Australian Air Force's MRH-90 FFSs;
- 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;
- Additional training services to the Ministry of Defence in the U.K.;
- Maintenance services for the Italian Air Force's C-130J simulator.

### Financial results

*(amounts in millions, except operating margins)*

		Q2-2009	Q1-2009	Q4-2008	Q3-2008	Q2-2008
Revenue	\$	58.4	56.9	54.1	58.9	54.5
Segment operating income	\$	11.4	9.6	7.6	9.5	7.9
Operating margins	%	19.5	16.9	14.0	16.1	14.5
Amortization & depreciation	\$	1.9	2.0	1.8	2.4	2.2
Capital expenditures	\$	5.8	2.4	3.4	4.3	4.3
Capital employed	\$	146.6	150.5	136.5	138.4	135.8

Backlog	\$	<b>785.2</b>	789.4	789.7	721.5	717.2
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Management's Discussion and Analysis

**Revenue up by 3% over last quarter and by 7% year over year**

The increase over last quarter was mainly attributable to an increased demand for training in our helicopter training centre in Benson, U.K.

The increase year over year was mainly a result of the above-mentioned reason, as well as an increased level of effort on some of our maintenance services contracts on various German military bases and increased C-130 and Predator services to the U.S. Air Force.

Revenue year to date is \$115.3 million, 5% or \$5.8 million higher than the same period last year.

**Segment operating income up by 19% over last quarter and by 44% year over year**

The increase over last quarter and year over year was mainly due to the above-mentioned increase in revenue. In addition, we received a higher dividend from a U.K.-based investment of TS/M compared to last quarter. The dividend, which was \$1.9 million this quarter, similar to what we received last year, is a component of TS/M's recurring business, even though it is not received evenly throughout the year.

Segment operating income for the first six months of the year was \$21.0 million, 47% or \$6.7 million higher than the same period last

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**7.1 Consolidated cash movements**

(amounts in millions)	Three months ended			Six months ended	
	September 30			September 30	
	2008	2007		2008	2007
		Restated		Restated	
Cash provided by continuing operating activities*	\$ 79.3	\$ 65.0	\$	\$ 149.7	\$ 134.2
Changes in non-cash working capital	(19.9)	32.7		(119.0)	(65.2)
Net cash provided by continuing operations	\$ 59.4	\$ 97.7	\$	\$ 30.7	\$ 69.0
Maintenance capital expenditures	(7.8)	(59.0)		(13.3)	(66.5)
Other assets	(0.9)	(0.9)		(2.0)	(3.4)
Cash dividends	(7.5)	(2.5)		(14.6)	(4.9)
Free cash flow <sup>11</sup>	\$ 43.2	\$ 35.3	\$	\$ 0.8	\$ (5.8)
Growth capital expenditures	(42.8)	(28.4)		(75.7)	(53.6)
Deferred development costs	(2.2)	(4.9)		(4.1)	(9.7)
Deferred pre-operating costs	(0.7)	(0.1)		(0.9)	(0.4)
Other cash movements, net	(0.3)	2.1		7.1	9.0
Business acquisitions (net of cash and cash equivalents acquired)	0.1	(1.8)		(38.7)	(40.7)
Effect of foreign exchange rate changes on cash and cash equivalents	(0.5)	(6.0)		(2.8)	(12.7)
Net decrease in cash before proceeds and repayment of long-term debt	\$ (3.2)	\$ (3.8)	\$	\$ (114.3)	\$ (113.9)

\* before changes in non-cash working capital

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

**Free cash flow of \$43.2 million, up \$85.6 million from last quarter and up \$7.9 million year over year**

The increase over last quarter was mainly attributable to net cash provided by continuing operations increasing by \$88.1 million, explained largely by reduced investment in non-cash working capital. This was partially offset by higher maintenance capital expenditures.

The increase year over year was mainly due to lower maintenance capital expenditures, offset by net cash provided by continuing operations decreasing by \$38.3 million over last year, explained largely by higher investment in non-cash working capital, as well as additional cash dividends issued this quarter. Last year, maintenance capital expenditures included the buyback of some leased simulators that were already part of our network.

Free cash flow year to date is \$0.8 million, \$6.6 million higher than in the same period last year. This increase is mainly attributable to lower maintenance capital expenditures as explained above, partly offset by net cash provided by continuing operations, explained largely by higher investment in non-cash working capital, as well as additional cash dividends issued this year.

**Capital expenditures of \$50.6 million**

Growth capital expenditures<sup>12</sup> of \$42.8 million this quarter were for the ongoing investment to expand our training network to address additional market share and in response to increased training demands in new markets. Maintenance capital expenditures<sup>13</sup> were \$7.8 million this quarter.

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

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

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## Management's Discussion and Analysis

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

		<b>As at September 30 2008</b>		As at June 30 2008		As at March 31 2008
<i>(amounts in millions)</i>						
<b>Use of capital:</b>						
Non-cash working capital	\$	<b>(22.5)</b>	\$	(32.8)	\$	(138.1)
Property, plant and equipment, net		<b>1,103.6</b>		1,081.3		1,046.8
Other long-term assets		<b>409.8</b>		418.6		380.0
Other long-term liabilities		<b>(221.2)</b>		(224.9)		(216.1)
Total capital employed	\$	<b>1,269.7</b>	\$	1,242.2	\$	1,072.6
<b>Source of capital:</b>						
Net debt	\$	<b>256.5</b>	\$	254.5	\$	124.1
Shareholders' equity		<b>1,013.2</b>		987.7		948.5
Source of capital	\$	<b>1,269.7</b>	\$	1,242.2	\$	1,072.6

**Capital employed<sup>14</sup> increased 2% this quarter**

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

Our return on capital employed<sup>15</sup> (ROCE) was 16.9% (15.0% adjusted for operating leases) this quarter compared to 15.4% (13.0% adjusted for operating leases) for the second quarter of last year.

**Non-cash working capital<sup>16</sup> increased by \$10.3 million this quarter**

The increase was mainly from higher inventories and accounts receivable. The increase was partly offset by an increase in accounts payable and accrued liabilities, an increase in deposits on contracts as well as a reduction in prepaid expenses and income taxes recoverable.

**Net property, plant and equipment up \$22.3 million since last quarter**

The increase was mainly from capital expenditures of \$50.6 million, offset by a negative impact of \$21.0 million caused by foreign exchange variation and by normal depreciation of \$17.3 million.

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

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

Source of capital:

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

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

<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).



## Management's Discussion and Analysis

### Net debt<sup>17</sup> stable this quarter

The increase of \$2.0 million was largely caused by a \$3.2 million net decrease in cash, before proceeds and repayment of long-term debt and by assumption of debt held by acquired businesses, offset by the appreciation of the Canadian dollar against our foreign denominated debt.

### Change in net debt

<i>(amounts in millions)</i>	Three months ended September 30, 2008	Six months ended September 30, 2008
Net debt, beginning of period	\$ 254.5	\$ 124.1
Impact of cash movements on net debt (see table in the cash movements section)	3.2	114.3
Business acquisitions and others	1.5	23.7
Effect of foreign exchange rate changes on long-term debt	(2.7)	(5.6)
Increase in net debt during the period	\$ 2.0	\$ 132.4
Net debt, end of period	\$ 256.5	\$ 256.5

The level of debt versus equity in the capital structure will be maintained at levels appropriate for a given economic cycle and according to the Company's growth strategy relative to the different business segments and therefore adjusted over time to appropriate levels.

### Shareholders' equity increased by \$25.5 million this quarter

The increase in equity was mainly because of net earnings (\$48.7 million) and the proceeds from the share issue and contributed surplus (\$0.6 million) offset by a decrease in accumulated other comprehensive loss (\$16.1 million). This was after accounting for dividends (\$7.7 million).

#### *Outstanding share data*

Our articles of incorporation authorize the issue of an unlimited number of common shares, and an unlimited number of preferred shares issued in series. We had a total of 254,886,406 common shares issued and outstanding as at September 30, 2008 with total share capital of \$428.6 million.

As at October 30, 2008, we had a total of 254,893,455 common shares issued and outstanding.

## 9. ACQUISITIONS

### Sabena Flight Academy

In June 2008, the Company acquired Sabena Flight Academy (Sabena) for a total cost, including acquisition costs, of \$67.2 million composed primarily of cash and assumed debt. Sabena offers cadet training, advanced training and aviation consulting for airlines and self-sponsored pilot candidates. The total costs do not include potential additional consideration of \$6.3 million that is contingent on certain conditions being satisfied, which, if met, would be recorded as additional goodwill. The allocation of the purchase price is preliminary and is expected to be completed in the near future.

### Academia Aeronautica de Evora S.A.

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

Goodwill recognized for these transactions, which is not deductible for tax purposes, amounts to \$19.9 million. As well, a customer relationship intangible asset in the amount of \$10.7 million and a trade name intangible asset in the amount of \$0.1 million have

been recognized regarding these transactions. These transactions were accounted for under the purchase method and the operating results have been included in the consolidated results of the Company since the date of each respective acquisition. The net assets of these acquisitions are included in the Training & Services/Civil segment.

<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.

## Management's Discussion and Analysis

### Xwave

In August 2008, the Company signed an asset purchase agreement to acquire Bell Aliant's Defence, Security and Aerospace business unit which currently operates under the Xwave brand for approximately \$15.1 million. As at September 30, 2008, this transaction was not yet closed and the Company has not consolidated Xwave. This transaction is subject to customary closing conditions and is anticipated to close at the end of the year.

## 10. CHANGES IN ACCOUNTING STANDARDS

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

### ***Financial instruments disclosures and presentation***

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

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

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

### ***Capital disclosures***

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

### ***Inventories***

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

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

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

We have a team performing a high-level accounting diagnostic and identifying differences between IFRS and accounting policies and procedures currently adopted by CAE. The Company is currently evaluating the impact of adopting IFRS 1, *First-time Adoption of International Financial Reporting Standards*, elections. Furthermore, we have finalized the design and planning phase of the

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IFRS implementation. We are completing the identification of possible accounting, information system and business solutions for the long-term implementation plan. We commenced IFRS training for our senior finance personnel to inform them of the impact on CAE's current reporting standards.

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

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## Management's Discussion and Analysis

**12. CONTROLS AND PROCEDURES****12.1 Evaluation of disclosure controls and procedures**

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

		Q1	Q2	Q3	Q4	Year to date
<i>(unaudited amounts in millions, except per share amounts)</i>						
<b>Fiscal 2009</b>						
Revenue	\$	392.1	406.7	*	*	798.8
Earnings from continuing operations	\$	47.0	48.9	*	*	95.9
Basic earnings per share from continuing operations	\$	0.18	0.19	*	*	0.38
Diluted earnings per share from continuing operations	\$	0.18	0.19	*	*	0.38
Net earnings	\$	46.1	48.7	*	*	94.8
Basic earnings per share	\$	0.18	0.19	*	*	0.37
Diluted earnings per share	\$	0.18	0.19	*	*	0.37
<b>Fiscal 2008</b>						
Total						
Revenue	\$	358.3	353.9	344.8	366.6	1,423.6
Earnings from continuing operations	\$	38.7	39.0	40.1	47.0	164.8
Basic earnings per share from continuing operations	\$	0.15	0.15	0.16	0.19	0.65
Diluted earnings per share from continuing operations	\$	0.15	0.15	0.16	0.18	0.65
Net earnings	\$	38.7	38.9	39.5	35.6	152.7
Basic earnings per share	\$	0.15	0.15	0.16	0.14	0.60
Diluted earnings per share	\$	0.15	0.15	0.16	0.14	0.60
<b>Fiscal 2007</b>						
Total						
Revenue	\$	301.8	280.4	331.2	337.3	1,250.7
Earnings from continuing operations	\$	33.0	31.3	29.7	35.1	129.1
Basic earnings per share from continuing operations	\$	0.13	0.12	0.12	0.14	0.51
Diluted earnings per share from continuing operations	\$	0.13	0.12	0.12	0.14	0.51
Net earnings	\$	32.4	31.0	29.7	34.3	127.4
Basic earnings per share	\$	0.13	0.12	0.12	0.14	0.51
Diluted earnings per share	\$	0.13	0.12	0.12	0.14	0.50

\* not available

## Consolidated Financial Statements

## Consolidated Balance Sheets

	<b>As at September 30</b>	As at March 31
<i>(Unaudited)</i>	<b>2008</b>	2008
<i>(amounts in millions of Canadian dollars)</i>		
<b>Assets</b>		
<i>Current assets</i>		
Cash and cash equivalents	\$ 149.8	\$ 255.7
Accounts receivable (Note 6)	256.4	255.0
Inventories	334.3	229.9
Prepaid expenses	25.4	32.7
Income taxes recoverable	35.7	39.0
Future income taxes	11.1	14.1
	\$ 812.7	\$ 826.4
Property, plant and equipment, net	1,103.6	1,046.8
Future income taxes	73.1	64.3
Intangible assets	72.2	62.0
Goodwill	135.8	115.5
Other assets	128.7	138.2
	\$ 2,326.1	\$ 2,253.2
<b>Liabilities and shareholders equity</b>		
<i>Current liabilities</i>		
Accounts payable and accrued liabilities	\$ 468.4	\$ 482.7
Deposits on contracts	199.7	209.3
Current portion of long-term debt	96.3	27.3
Future income taxes	17.3	16.8
	\$ 781.7	\$ 736.1
Long-term debt	310.0	352.5
Deferred gains and other long-term liabilities	175.5	184.9
Future income taxes	45.7	31.2
	\$ 1,312.9	\$ 1,304.7
<b>Shareholders equity</b>		
Capital stock	\$ 428.6	\$ 418.9
Contributed surplus	9.2	8.3
Retained earnings	724.0	644.5
Accumulated other comprehensive loss	(148.6)	(123.2)
	1,013.2	\$ 948.5

\$

\$

**2,326.1**

\$

2,253.2

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

## Consolidated Statements of Earnings

<i>(Unaudited)</i> <i>(amounts in millions of Canadian dollars, except per share amounts)</i>	Three months ended September 30		Six months ended September 30	
	2008	2007	2008	2007
Revenue	\$ 406.7	\$ 353.9	\$ 798.8	\$ 712.2
Earnings before interest and income taxes (Note 12)	\$ 75.5	\$ 62.1	\$ 146.8	\$ 120.1
Interest expense, net (Note 5)	5.2	5.4	9.5	8.0
Earnings before income taxes	\$ 70.3	\$ 56.7	\$ 137.3	\$ 112.1
Income tax expense	21.4	17.7	41.4	34.4
Earnings from continuing operations	\$ 48.9	\$ 39.0	\$ 95.9	\$ 77.7
Results of discontinued operations	(0.2)	(0.1)	(1.1)	(0.1)
<b>Net earnings</b>	<b>\$ 48.7</b>	<b>\$ 38.9</b>	<b>\$ 94.8</b>	<b>\$ 77.6</b>
Basic and diluted earnings per share from continuing operations	\$ 0.19	\$ 0.15	\$ 0.38	\$ 0.31
Basic and diluted earnings per share	\$ 0.19	\$ 0.15	\$ 0.37	\$ 0.31
Weighted average number of shares outstanding (basic)	254.9	253.5	254.6	253.0
Weighted average number of shares outstanding (diluted)	255.4	254.9	255.2	254.3

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



## Consolidated Financial Statements

## Consolidated Statements of Changes in Shareholders' Equity

*(Unaudited)**six months ended September 30, 2008**(amounts in millions of Canadian dollars, except number of shares)*

	Number of Shares	Common Shares Stated Value	Contributed Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balances, beginning of period	253,969,836	\$ 418.9	\$ 8.3	\$ 644.5	\$ (123.2)	\$ 948.5
Stock options exercised	850,625	8.4				8.4
Transfer upon exercise of stock options		0.6	(0.6)			
Stock dividends	65,945	0.7		(0.7)		
Stock-based compensation			1.5			1.5
Net earnings				94.8		94.8
Dividends				(14.6)		(14.6)
Other comprehensive loss					(25.4)	(25.4)
Balances, end of period	254,886,406	\$ 428.6	\$ 9.2	\$ 724.0	\$ (148.6)	\$ 1,013.2

*(Unaudited)**six months ended September 30, 2007**(amounts in millions of Canadian dollars, except number of shares)*

	Number of Shares	Common Shares Stated Value	Contributed Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balances, beginning of period	251,960,449	\$ 401.7	\$ 5.7	\$ 510.2	\$ (87.7)	\$ 829.9
Stock options exercised	1,738,345	13.5				13.5
Transfer upon exercise of stock options		2.0	(2.0)			
Stock dividends	11,528	0.2		(0.2)		
Stock-based compensation			1.9			1.9

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Cumulative effect of implementing accounting standards (Note 2)				(8.3)		(3.5)		(11.8)			
Net earnings				77.6				77.6			
Dividends				(4.9)				(4.9)			
Other comprehensive loss						(75.8)		(75.8)			
Balances,  end of period	253,710,322	\$	417.4	\$	5.6	\$	574.4	\$	(167.0)	\$	830.4

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

## Consolidated Statements of Comprehensive Income

<i>(Unaudited)</i> <i>(amounts in millions of Canadian dollars)</i>	<b>Three months ended September 30</b>			<b>Six months ended September 30</b>		
	<b>2008</b>	2007		<b>2008</b>	2007	
<b>Net earnings</b>	<b>\$ 48.7</b>	\$ 38.9	<b>\$</b>	<b>\$ 94.8</b>	\$ 77.6	
Other comprehensive income (loss), net of income taxes:						
<b>Foreign currency translation adjustment</b>						
Net foreign exchange losses on translation of financial statements of self-sustaining foreign operations	<b>\$ (14.0)</b>	\$ (43.1)	<b>\$</b>	<b>\$ (27.1)</b>	\$ (110.6)	
Net change in (losses) gains on certain long-term debt denominated in foreign currency and designated as hedges on net investments of self-sustaining foreign operations	<b>(1.4)</b>	6.3		<b>(1.1)</b>	14.6	
Income tax adjustment	<b>(0.1)</b>	0.4		<b>(0.1)</b>	0.9	
	<b>\$ (15.5)</b>	\$ (36.4)	<b>\$</b>	<b>\$ (28.3)</b>	\$ (95.1)	
<b>Net changes in cash flow hedge</b>						
Net change in gains on derivative items designated as hedges of cash flows	<b>\$ 3.7</b>	\$ 15.3	<b>\$</b>	<b>\$ 11.8</b>	\$ 39.3	
Reclassifications to income or to the related non-financial assets or liabilities	<b>(4.5)</b>	(4.8)		<b>(7.6)</b>	(10.7)	
Income tax adjustment	<b>0.2</b>	(3.5)		<b>(1.3)</b>	(9.3)	
	<b>\$ (0.6)</b>	\$ 7.0	<b>\$</b>	<b>\$ 2.9</b>	\$ 19.3	
<b>Total other comprehensive loss</b>	<b>\$ (16.1)</b>	\$ (29.4)	<b>\$</b>	<b>\$ (25.4)</b>	\$ (75.8)	
<b>Comprehensive income</b>	<b>\$ 32.6</b>	\$ 9.5	<b>\$</b>	<b>\$ 69.4</b>	\$ 1.8	

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

## Consolidated Statement of Accumulated Other Comprehensive Loss

<i>(Unaudited)</i> <i>as at September 30, 2008</i> <i>(amounts in millions of Canadian dollars)</i>	Foreign Currency Translation Adjustment	Cash Flow Hedge	<b>Accumulated Other Comprehensive Loss</b>

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Balance in accumulated other comprehensive loss at beginning of the period	\$	(122.8)	\$	(0.4)	\$	(123.2)
Details of other comprehensive loss:						
Net change in (losses) gains		(28.2)		11.8		(16.4)
Reclassification to income or to the related non-financial assets or liabilities				(7.6)		(7.6)
Income tax adjustment		(0.1)		(1.3)		(1.4)
Total other comprehensive loss	\$	(28.3)	\$	2.9	\$	(25.4)
Balance in accumulated other comprehensive loss at end of period	\$	(151.1)	\$	2.5	\$	(148.6)

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

## Consolidated Financial Statements

## Consolidated Statements of Cash Flows

<i>(Unaudited)</i> <i>(amounts in millions of Canadian dollars)</i>	Three months ended		Six months ended	
	2008	September 30 2007	2008	September 30 2007
<b>Operating activities</b>				
Net earnings	\$ 48.7	\$ 38.9	\$ 94.8	\$ 77.6
Results of discontinued operations	0.2	0.1	1.1	0.1
Earnings from continuing operations	48.9	39.0	95.9	77.7
Adjustments to reconcile earnings to cash flows from operating activities:				
Depreciation	17.3	15.6	33.0	30.2
Financing cost amortization	0.2	0.3	0.4	0.5
Amortization and write down of intangible and other assets	4.2	4.6	8.4	8.5
Future income taxes	7.5	5.3	13.2	10.1
Investment tax credits	5.9	3.7	9.3	7.5
Stock-based compensation plans	(2.4)	1.8	(6.6)	(1.1)
Employee future benefit net	0.2	(0.1)	0.4	(0.2)
Other	(2.5)	(5.2)	(4.3)	1.0
Changes in non-cash working capital (Note 7)	(19.9)	32.7	(119.0)	(65.2)
<b>Net cash provided by operating activities</b>	<b>59.4</b>	<b>97.7</b>	<b>30.7</b>	<b>69.0</b>
<b>Investing activities</b>				
Business acquisitions (net of cash and cash equivalents acquired) (Note 3)	0.1	(1.8)	(38.7)	(40.7)
Capital expenditures	(50.6)	(87.4)	(89.0)	(120.1)
Deferred development costs	(2.2)	(4.9)	(4.1)	(9.7)
Deferred pre-operating costs	(0.7)	(0.1)	(0.9)	(0.4)
Other	(0.9)	(0.9)	(2.0)	(3.4)
<b>Net cash used in investing activities</b>	<b>(54.3)</b>	<b>(95.1)</b>	<b>(134.7)</b>	<b>(174.3)</b>
<b>Financing activities</b>				
Net borrowing under revolving unsecured credit facilities				15.0
Proceeds from long-term debt, net of transaction costs and debt basis adjustment	13.9	25.2	22.5	109.4
Reimbursement of long-term debt	(8.6)	(12.1)	(14.1)	(16.4)
Dividends paid	(7.5)	(2.5)	(14.6)	(4.9)
Common stock issuance		1.9	8.4	13.5
Other	(0.3)	0.2	(1.3)	(4.5)
<b>Net cash (used in) provided by financing activities</b>	<b>(2.5)</b>	<b>12.7</b>	<b>0.9</b>	<b>112.1</b>
<b>Effect of foreign exchange rate changes on cash and cash equivalents</b>	<b>(0.5)</b>	<b>(6.0)</b>	<b>(2.8)</b>	<b>(12.7)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>2.1</b>	<b>9.3</b>	<b>(105.9)</b>	<b>(5.9)</b>

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<b>Cash and cash equivalents at beginning of period</b>	<b>147.7</b>	135.0	<b>255.7</b>	150.2
<b>Cash and cash equivalents at end of period</b>	<b>\$ 149.8</b>	\$ 144.3	<b>\$ 149.8</b>	\$ 144.3

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

## Notes to the Consolidated Financial Statements

## Notes to the Consolidated Financial Statements (Unaudited)

**NOTE 1 NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES****Nature of operations**

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

The Company's operations are managed through four segments:

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

**Seasonality and cyclicity of the business**

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

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

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

**Use of estimates**

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

**Generally accepted accounting principles and financial statement presentation**

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

## Notes to the Consolidated Financial Statements

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

These consolidated statements do not include all of the disclosures applicable to annual consolidated financial statements; for a full description of the Company's accounting policies, refer to the Company's annual consolidated financial statements for the year ended March 31, 2008 available on-line at [www.sedar.com](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 consolidated financial statements include the accounts of CAE Inc. and all majority-owned subsidiaries and variable interest entities for which the Company is the primary beneficiary. They also include the Company's proportionate share of assets, liabilities and earnings of joint ventures in which the Company has an interest. All significant intercompany accounts and transactions have been eliminated. Investments over which the Company exercises significant influence are accounted for using the equity method and portfolio investments are accounted at fair value unless there is no readily available market value.

## NOTE 2 CHANGE IN ACCOUNTING POLICIES

### Implemented in fiscal 2009

#### ***Financial instruments disclosures and presentation***

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

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

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

#### ***Capital disclosures***

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

#### ***Inventories***

Effective April 1, 2008, the Company adopted CICA Handbook Section 3031, *Inventories*, which replaces existing Section 3030 with the same title. The new section specifies the measurement of inventory at the lower of cost and net realizable value with the possibility of reversing previous write downs. It provides more extensive guidance on the determination of cost including allocation



of overhead, and narrows the permitted cost formula to apply for the recognition to expense as well as expanding disclosure requirements. There were no adjustments to the Company's consolidated financial statements upon adoption of this new standard.

### Notes to the Consolidated Financial Statements

The amount of inventory, excluding long-term contracts, recognized as cost of sales was as follows:

<i>(Unaudited)</i>		Three months ended September 30, 2008	Six months ended September 30, 2008
<i>(amounts in millions)</i>			
Work in progress	\$	12.8	\$ 30.4
Raw materials, supplies and manufacturing products		18.7	34.7
	\$	31.5	\$ 65.1

The carrying amount of inventories pledged as security for loans was \$2.2 million as at September 30, 2008.

### Implemented in fiscal 2008

#### **Accounting changes**

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

#### **Financial instrument and hedging relationships**

On April 1, 2007, the Company adopted CICA Handbook Section 1530, *Comprehensive Income*, Section 3855,

*Financial Instruments - Recognition and Measurement*, and Section 3865 *Hedges*, which provided accounting guidelines for recognition and measurement of financial assets, financial liabilities and non-financial derivatives, and described when and how hedge accounting may be applied.

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

### NOTE 3 BUSINESS ACQUISITIONS

#### **Sabena Flight Academy**

In June 2008, the Company acquired Sabena Flight Academy (Sabena) for a total cost, including acquisition costs, of \$67.2 million composed primarily of cash and assumed debt. Sabena offers cadet training, advanced training and aviation consulting for airlines and self-sponsored pilot candidates. The total costs do not include a potential additional consideration of \$6.3 million that is contingent on certain conditions being satisfied, which, if met, would be recorded as additional goodwill. The allocation of the purchase price is preliminary and is expected to be completed in the near future.

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

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

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Goodwill recognized for these transactions, which is not deductible for tax purposes, amounts to \$19.9 million. As well, a customer relationship intangible asset in the amount of \$10.7 million and a trade name intangible asset in the amount of \$0.1 million have been recognized regarding these transactions. These transactions were accounted for under the purchase method and the operating results have been included in the consolidated results of the Company since the date of each respective acquisition. The net assets of these acquisitions are included in the Training & Services/Civil segment.

### Xwave

In August 2008, the Company signed an asset purchase agreement to acquire Bell Aliant's Defence, Security and Aerospace business unit which currently operates under the Xwave brand for approximately \$15.1 million. As at September 30, 2008, this transaction was not yet closed and the Company has not consolidated Xwave. This transaction is subject to customary closing conditions and is anticipated to close at the end of the year.

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## Notes to the Consolidated Financial Statements

**NOTE 4 INVESTMENTS IN JOINT VENTURES**

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

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

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

<i>(Unaudited)</i> <i>(amounts in millions)</i>	<b>As at September 30</b>	As at March 31
	<b>2008</b>	2008
<b>Assets</b>		
Current assets	\$ 53.1	\$ 33.8
Property, plant and equipment and other non-current assets	191.8	163.1
<b>Liabilities</b>		
Current liabilities	34.5	22.9
Long-term debt (including current portion)	85.3	75.9
Deferred gains and other long-term liabilities	1.3	

<i>(Unaudited)</i> <i>(amounts in millions)</i>	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>September 30</b>		<b>September 30</b>	
	<b>2008</b>	2007	<b>2008</b>	2007
<b>Earnings</b>				
Revenue	\$ 23.8	\$ 14.9	\$ 37.5	\$ 28.7
Net earnings	3.6	2.6	7.9	5.2
Segmented operating income				
Simulation Products/Military	0.7	0.2	1.7	0.8
Training and Services/Civil	3.8	2.9	7.7	5.6
Training and Services/Military	(0.2)		(0.4)	(0.1)

<i>(Unaudited)</i> <i>(amounts in millions)</i>	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>September 30</b>		<b>September 30</b>	
	<b>2008</b>	2007	<b>2008</b>	2007
<b>Cash flows provided by (used in):</b>				
Operating activities	\$ 11.1	\$ 7.1	\$ 17.5	\$ 14.7
Investing activities	(14.8)	(6.2)	(19.1)	(11.3)
Financing activities	4.3	4.6	12.5	13.4

**NOTE 5 INTEREST EXPENSE, NET**

Details of interest expense (income) are as follows:

<i>(Unaudited)</i> <i>(amounts in millions)</i>	Three months ended		Six months ended	
	2008	September 30 2007	2008	September 30 2007
Long-term debt interest expense	\$ 7.0	\$ 6.6	\$ 13.1	\$ 10.9
Amortization of deferred financing costs and other	0.8	0.6	1.6	1.2
Interest capitalized	(1.5)	(1.1)	(2.8)	(2.1)
Interest on long-term debt	\$ 6.3	\$ 6.1	\$ 11.9	\$ 10.0
Interest income	\$ (0.7)	\$ (0.9)	\$ (1.4)	\$ (1.6)
Other interest expense (income), net	(0.4)	0.2	(1.0)	(0.4)
Interest income, net	\$ (1.1)	\$ (0.7)	\$ (2.4)	\$ (2.0)
Interest expense, net	\$ 5.2	\$ 5.4	\$ 9.5	\$ 8.0

**NOTE 6 ACCOUNTS RECEIVABLE**

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

Details of accounts receivable were as follows:

<i>(Unaudited)</i> <i>(amounts in millions)</i>	As at September 30		As at March 31
	2008		2008
Past due trade receivables			
1-30 days	\$ 43.7	\$	38.0
31-60 days	20.2		10.7
61-90 days	15.3		6.3
Greater than 90 days	25.3		20.6
Total	\$ 104.5	\$	75.6
Allowance for doubtful accounts	\$ (11.0)	\$	(7.4)
Current trade receivables	69.3		81.2
Accrued receivables	48.9		48.5
Derivative assets	17.3		17.2
Other receivables	27.4		39.9

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Total accounts receivable \$ 256.4 \$ 255.0

Changes in the allowance for doubtful accounts were as follows as at September 30, 2008:

<i>(Unaudited)</i>	Three months ended		Six months ended
<i>(amounts in millions)</i>	September 30, 2008		September 30, 2008
Balance at beginning of period	\$	(8.8)	\$ (7.4)
Additions		(4.9)	(7.8)
Amounts charged off		2.6	4.0
Foreign exchange		0.1	0.2
Balance at end of period	\$	(11.0)	\$ (11.0)

## Notes to the Consolidated Financial Statements

**NOTE 7 SUPPLEMENTARY INFORMATION**

<i>(Unaudited)</i> <i>(amounts in millions)</i>	Three months ended		Six months ended	
	2008	September 30 2007	2008	September 30 2007
<b>Cash provided by (used in) non-cash working capital:</b>				
Accounts receivable	\$ (10.4)	\$ 30.4	\$ 11.1	\$ (11.2)
Inventories	(57.5)	8.3	(95.6)	5.8
Prepaid expenses	2.7	(0.2)	7.9	0.1
Income taxes recoverable	(2.7)	(3.6)	(5.9)	(12.9)
Accounts payable and accrued liabilities	45.0	16.3	(28.4)	(47.6)
Deposits on contracts	3.0	(18.5)	(8.1)	0.6
Changes in non-cash working capital	\$ (19.9)	\$ 32.7	\$ (119.0)	\$ (65.2)
<b>Supplemental cash flow disclosure:</b>				
Interest paid	\$ 4.7	\$ 4.4	\$ 13.5	\$ 11.2
Income taxes paid (received)	\$ 4.5	\$ 9.9	\$ 13.7	\$ 21.2
<b>Supplemental statements of earnings disclosure:</b>				
Foreign exchange gains (losses) on financial instruments				
	recognized in earnings:			
Loans and receivables	\$ 5.3	\$ (15.1)	\$ 3.7	\$ (22.4)
Financial assets and financial liabilities required to be classified as held for trading	(0.5)	6.5	(0.7)	2.2
Other financial liabilities	(5.6)	7.1	(3.2)	16.5
Foreign exchange loss	\$ (0.8)	\$ (1.5)	\$ (0.2)	\$ (3.7)

**Stock-based compensation plans**

The net effect of the equity swap agreements relating to the DSU and LTI-DSU programs partly offsets movements in the company's share price impacting the cost of these programs. This net effect is presented in the line item associated with stock-based compensation plans.

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

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

<i>(Unaudited)</i> <i>(amounts in millions)</i>	Three months ended September 30, 2008	Six months ended September 30, 2008
Outstanding contribution receivable, beginning of period	\$ 19.2	\$ 24.2
Contributions	10.9	22.1

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Payments received		(20.3)		(36.5)
Outstanding contribution receivable, end of period	\$	9.8	\$	9.8



Notes to the Consolidated Financial Statements  
**Aggregate information about programs**

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

<i>(Unaudited)</i> <i>(amounts in millions)</i>	<b>Three months ended</b> <b>September 30</b>		<b>Six months ended</b> <b>September 30</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Contributions credited to capitalized costs:				
Project Phoenix	\$ 3.0	\$ 6.7	\$ 5.7	\$ 11.0
Contributions credited to income:				
Project Phoenix	7.9	8.6	16.4	18.1
Total contributions:				
Project Phoenix	\$ 10.9	\$ 15.3	\$ 22.1	\$ 29.1
Royalty expenses:				
Project Phoenix	\$	\$	\$	\$
Previous programs	2.4	2.1	5.0	4.2

**NOTE 9 EMPLOYEE FUTURE BENEFITS**

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

<i>(Unaudited)</i> <i>(amounts in millions)</i>	<b>Three months ended</b> <b>September 30</b>		<b>Six months ended</b> <b>September 30</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Current service cost	\$ 2.5	\$ 2.1	\$ 4.7	\$ 4.2
Interest cost on projected pension obligations	3.7	3.1	7.0	6.3
Expected return on plan assets	(3.3)	(3.0)	(6.6)	(6.2)
Amortization of net actuarial loss	0.5	0.5	1.0	1.1
Amortization of past service costs	0.1	0.1	0.2	0.2
Net pension expense	\$ 3.5	\$ 2.8	\$ 6.3	\$ 5.6

**NOTE 10 CAPITAL MANAGEMENT**

The Company's objectives when managing capital are threefold:

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

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

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

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## Notes to the Consolidated Financial Statements

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

<i>(Unaudited)</i> <i>(amounts in millions)</i>		<b>As at September 30 2008</b>		As at March 31 2008
Total debt	\$	<b>406.3</b>	\$	379.8
Add: Present value of operating leases (held off balance sheet)		<b>201.9</b>		200.2
Less: Cash and cash equivalents		<b>(149.8)</b>		(255.7)
Adjusted net debt	\$	<b>458.4</b>	\$	324.3
Shareholders' equity	\$	<b>1,013.2</b>	\$	948.5
<b>Adjusted net debt : shareholders' equity</b>		<b>31:69</b>		25:75

The increase in the adjusted net debt to equity ratio compared to March 31, 2008 resulted primarily from the increase in net debt that occurred as a result of cash used for the acquisition of Sabena Flight Academy and other general corporate and working capital purposes.

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

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

## Notes to the Consolidated Financial Statements

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

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

(Unaudited)

as at September 30, 2008

(amounts in millions)

		Held for Trading	Available for Sale	Loans & Receivables	Carrying Value Total	Fair Value
<b>Financial assets</b>						
Cash and cash equivalents	\$	149.8	\$	\$	149.8 \$	149.8
Accounts receivable <sup>(a)</sup>				218.1 <sup>(b)</sup>	218.1	218.1
Other assets <sup>(a)</sup>		10.1 <sup>(c)</sup>	21.0 <sup>(d)</sup>	1.2 <sup>(e)</sup>	32.3	32.3
Derivative assets		8.8 <sup>(f)</sup>			8.8	8.8
	\$	168.7	\$	21.0	\$	409.0 \$
				\$	219.3	\$
					409.0 \$	409.0
<b>Financial liabilities</b>						
Accounts payable and accrued liabilities <sup>(a)</sup>				352.2 <sup>(g)</sup>	352.2 \$	352.2
Total long-term debt				406.3	406.3	414.0
Deferred gains and other long-term liabilities <sup>(a)</sup>				0.9 <sup>(h)</sup>	0.9	0.9
Derivative liabilities			12.6 <sup>(f)</sup>		12.6	12.6
			\$	12.6	\$	772.0 \$
				\$	759.4	\$
					772.0 \$	779.7

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

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

(c) Includes restricted cash.

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

(e) Includes long-term receivables.

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

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

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

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## Notes to the Consolidated Financial Statements

(Unaudited)

as at March 31, 2008

(amounts in millions)

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

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

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

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

(c) Includes restricted cash.

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

(e) Includes long-term receivables.

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

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

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

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

As part of its financing transactions, the Company, through its subsidiaries, has pledged certain financial assets including cash and cash equivalents, accounts receivables, other assets and derivative assets. The aggregate carrying value of these pledged financial assets was \$69.2 million as at September 30, 2008 (\$70.7 million as at March 31, 2008).

## Financial risk management

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

## Credit risk

Credit risk is defined as the Company's exposure to a financial loss if a debtor fails to meet its obligations in accordance with the terms and conditions of its arrangements with the Company, in relation to financial instruments. The Company is exposed to credit

risk on its account receivables and certain other assets through its normal commercial activities. The Company is also exposed to credit risk through its normal treasury activities on its cash and cash equivalents, and derivative financial instrument assets.

### Notes to the Consolidated Financial Statements

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

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

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

As presented in the previous financial instrument tables, the carrying amount represents the maximum exposure to credit risk for each respective financial asset as at the relevant dates. In addition, an amount of \$15.5 million (\$15.6 million as at March 31, 2008) represents the maximum exposure to credit risk for elements excluded from the previous table.

#### **Liquidity risk**

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

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

## Notes to the Consolidated Financial Statements

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

<i>(Unaudited)</i>									
<i>as at September</i>									
<i>30, 2008</i>									
<i>(amounts in</i>									
<i>millions)</i>									
Accounts payable and	Carrying	Contractual	0-12	13-24	25-36	37-48	49-60		
	Amount	Cash Flows	Months	Months	Months	Months	Months	Months	Thereafter
(a, f)									
accrued liabilities	\$ 352.2	\$ 352.2	\$ 352.2	\$	\$		\$	\$	\$
Foreign exchange forward contracts (b)	(7.2)								
Outflow		633.5	523.7	87.5	18.4	3.9			
Inflow		(640.9)	(530.3)	(88.0)	(18.7)	(3.9)			
Total long-term debt (c)	406.3	518.5	119.0	59.9	49.8	70.5	56.6		162.7
Swap derivatives on total long-term debt (d)	(4.3)								
Outflow		85.9	10.0	10.8	11.2	10.3	7.8		35.8
Inflow		(90.7)	(10.3)	(10.7)	(11.5)	(11.2)	(8.1)		(38.9)
(e, f)									
Other long-term liabilities	0.9	0.9		0.8	0.1				
	\$ 747.9	\$ 859.4	\$ 464.3	\$ 60.3	\$ 49.3	\$ 69.6	\$ 56.3	\$	159.6

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

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

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

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

(e) Includes certain other long-term liabilities.

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

**Market risk**

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



*Foreign currency risk*

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

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

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

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

### Notes to the Consolidated Financial Statements

The Company's exposure to foreign exchange variation of 5% of our main three currencies, which is reasonably possible, does not have a significant impact on the Company's net earnings. The pre-tax impact on the OCI is \$21.2 million.

#### Interest rate risk

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

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

## NOTE 12 OPERATING SEGMENTS AND GEOGRAPHIC INFORMATION

### Results by segment

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

(Unaudited) three months ended September 30 (amounts in millions)	Simulation Products		Training & Services		Total	
	2008	2007	2008	2007	2008	2007
<b>Civil</b>						
External revenue	\$ 114.3	\$ 112.3	\$ 108.0	\$ 90.0	\$ 222.3	202.3
Segment operating income	23.4	26.2	19.1	14.6	42.5	40.8
Depreciation and amortization						
Property, plant and equipment	1.0	1.3	13.6	11.1	14.6	12.4
Intangible and other assets	0.6	0.7	2.1	2.4	2.7	3.1
Capital expenditures	1.4	1.4	42.3	79.3	43.7	80.7
<b>Military</b>						
External revenue	\$ 126.0	\$ 97.1	\$ 58.4	\$ 54.5	\$ 184.4	151.6
Segment operating income	21.6	13.4	11.4	7.9	33.0	21.3
Depreciation and amortization						
Property, plant and equipment	1.4	1.5	1.3	1.7	2.7	3.2
Intangible and other assets	0.9	1.0	0.6	0.5	1.5	1.5
Capital expenditures	1.1	2.4	5.8	4.3	6.9	6.7
<b>Total</b>						
External revenue	\$ 240.3	\$ 209.4	\$ 166.4	\$ 144.5	\$ 406.7	353.9
Segment operating income	45.0	39.6	30.5	22.5	75.5	62.1
Depreciation and amortization						
Property, plant and equipment	2.4	2.8	14.9	12.8	17.3	15.6

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Intangible and other assets	<b>1.5</b>	1.7	<b>2.7</b>	2.9	<b>4.2</b>	4.6
Capital expenditures	<b>2.5</b>	3.8	<b>48.1</b>	83.6	<b>50.6</b>	87.4

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## Notes to the Consolidated Financial Statements

<i>(Unaudited)</i> <i>six months ended September 30</i> <i>(amounts in millions)</i>	<b>Simulation</b>		<b>Training &amp; Services</b>		<b>Total</b>	
	<b>2008</b>	2007	<b>2008</b>	2007	<b>2008</b>	2007
<b>Civil</b>						
External revenue	\$ 250.9	\$ 225.3	\$ 218.2	\$ 184.8	\$ 469.1	410.1
Segment operating income	50.8	45.9	39.8	34.2	90.6	80.1
Depreciation and amortization						
Property, plant and equipment	2.1	2.3	25.5	22.1	27.6	24.4
Intangible and other assets	1.0	1.2	4.0	4.5	5.0	5.7
Capital expenditures	2.0	2.2	76.5	106.1	78.5	108.3
<b>Military</b>						
External revenue	\$ 214.4	\$ 192.6	\$ 115.3	\$ 109.5	\$ 329.7	302.1
Segment operating income	35.2	25.7	21.0	14.3	56.2	40.0
Depreciation and amortization						
Property, plant and equipment	2.8	2.9	2.6	2.9	5.4	5.8
Intangible and other assets	2.1	1.8	1.3	1.0	3.4	2.8
Capital expenditures	2.3	3.7	8.2	8.1	10.5	11.8
<b>Total</b>						
External revenue	\$ 465.3	\$ 417.9	\$ 333.5	\$ 294.3	\$ 798.8	712.2
Segment operating income	86.0	71.6	60.8	48.5	146.8	120.1
Depreciation and amortization						
Property, plant and equipment	4.9	5.2	28.1	25.0	33.0	30.2
Intangible and other assets	3.1	3.0	5.3	5.5	8.4	8.5
Capital expenditures	4.3	5.9	84.7	114.2	89.0	120.1

## Notes to the Consolidated Financial Statements

**Assets employed by segment**

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

<i>(Unaudited)</i> <i>(amounts in millions)</i>		<b>As at September 30 2008</b>		As at March 31 2008
Simulation Products/Civil	\$	255.1	\$	208.3
Simulation Products/Military		348.9		302.8
Training & Services/Civil		1,162.0		1,067.6
Training & Services/Military		216.7		219.8
Total assets employed	\$	1,982.7	\$	1,798.5
Assets not included in assets employed		343.4		454.7
Total assets	\$	2,326.1	\$	2,253.2

**Geographic information**

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

<i>(Unaudited)</i> <i>(amounts in millions)</i>	<b>Three months ended September 30</b>		<b>Six months ended September 30</b>	
	2008	2007	2008	2007
Revenue from external customers				
Canada	\$ 20.7	\$ 33.6	\$ 43.9	\$ 66.5
United States	130.4	111.3	269.2	218.9
United Kingdom	32.6	29.6	57.8	54.0
Germany	50.6	31.8	97.9	75.2
Netherlands	35.8	26.6	53.5	59.4
Other European countries	41.3	39.3	84.4	77.2
China	19.2	11.6	37.1	30.3
United Arab Emirates	13.1	9.7	28.3	24.4
Other Asian countries	24.3	16.5	54.2	36.6
Australia	25.7	29.4	44.7	37.5
Other countries	13.0	14.5	27.8	32.2
	\$ 406.7	\$ 353.9	\$ 798.8	\$ 712.2

<i>(Unaudited)</i> <i>(amounts in millions)</i>	<b>As at September 30 2008</b>	<b>As at March 31 2008</b>
Property, plant and equipment, goodwill and intangible assets		
Canada	\$ 194.1	\$ 205.9
United States	329.5	297.2
South America	61.2	66.1
United Kingdom	157.4	166.3
Spain	84.4	95.4
Germany	67.3	67.2
Belgium	80.0	27.1

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Netherlands	<b>114.4</b>	134.0
Other European countries	<b>43.9</b>	34.2
United Arab Emirates	<b>67.8</b>	63.6
Asia	<b>99.7</b>	54.3
Other countries	<b>11.9</b>	13.0
	<b>\$ 1,311.6</b>	<b>\$ 1,224.3</b>

