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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 40-F

(Check One)
o Registration statement pursuant to Section 12 of the Securities Exchange Act of 1934
or
ý Annual report pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934

For fiscal year ended: March 31, 2004
Commission File number: 1-31402

CAE INC.

(Exact name of Registrant as specified in its charter)

Canada	**3699**	**Not Applicable**
(Province or Other Jurisdiction of Incorporation or Organization)	*(Primary Standard Industrial Classification Code Number, if applicable)*	*(I.R.S. Employer Identification Number, if applicable)*

Suite 3060, Royal Bank Plaza, South Tower, Toronto, Ontario, M5J 2J1
416-865-0070
(Address and Telephone Number of Registrant's principal executive office)

CT Corporation System, 111 Eighth Avenue, 13th Floor, New York, NY 10011 (212) 894-8700
(Name, Address and Telephone Number of Agent for Service in the United States)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange On Which Registered**
Common Shares, including associated Common Share purchase rights pursuant to the Registrant's Shareholder Rights Plan, which purchase rights will trade together with the Common Shares	**New York Stock Exchange**

Securities registered or to be registered pursuant to Section 12(g) of the Act: none

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: none

For annual reports, indicate by check mark the information filed with this form:

ý Annual Information Form ý Audited Annual Financial Statements

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: **246,649,180**.

Indicate by check mark whether the registrant by filing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934 (the "Exchange Act"). If "Yes" is marked, indicate the file number assigned to the registrant in connection with such rule.

Yes o No ý

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13(d) or 15(d) of the Exchange Act during the proceeding 12 months (or for such shorter period that the registrant was required to file such reports); and (2) has been subject to such filing requirements in the past 90 days.

Yes ý No o

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to ensure that information required to be disclosed by CAE in reports filed with securities regulatory agencies is recorded, processed, summarized and reported on a timely basis and is accumulated and communicated to CAE's management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

The Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of CAE's disclosure controls and procedures (as defined in rules adopted by the U.S. Securities and Exchange Commission) as of March 31, 2004. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the design and operation of our disclosure controls and procedures were effective.

Internal controls over financial reporting are procedures designed to provide reasonable assurance that transactions are properly authorized, assets are safeguarded against unauthorized or improper use, and transactions are properly recorded and reported. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance with respect to the reliability of financial reporting and financial statement preparation. Accordingly, CAE's management, including our Chief Executive Officer and our Chief Financial Officer, does not expect that CAE's internal controls over financial reporting will prevent or detect all error and all fraud.

There has been no change in CAE's internal controls over financial reporting during the year ended March 31, 2004 that materially affected, or that is reasonably likely to materially affect, CAE's internal controls over financial reporting.

CAE will continue to periodically review its disclosure controls and procedures and internal controls over financial reporting and may make modifications from time to time as considered necessary or desirable. CAE has been undertaking a comprehensive review of its existing internal controls over financial reporting in preparation for the reporting and attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002 becoming effective for CAE in fiscal year ended March 31, 2006. In connection with such review, modifications to CAE's disclosure controls, procedures and internal controls over financial reporting may, as appropriate, be made to comply with this Section of the Act.

AUDIT COMMITTEE FINANCIAL EXPERT

CAE's board of directors has determined that it has at least one audit committee financial expert serving on its audit committee. The board of directors has determined that Mr. James F. Hankinson is an audit committee financial expert and is independent, as that term is defined by the New York Stock Exchange's corporate governance standards applicable to CAE.

The Securities and Exchange Commission has indicated that the designation of a person as an audit committee financial expert does not impose on such person any duties, obligations or liability that are greater than those imposed on such person as a member of the audit committee and the board of directors in the absence of such designation and does not affect the duties, obligations or liability of any other member of the audit committee or board of directors.

CODE OF ETHICS

CAE has adopted a code of ethics entitled, "Code of Business Conduct". The Code of Business Conduct applies to all officers and employees of CAE, including CAE's principal executive officer, principal financial officer, principal accounting officer, agents, representatives, contractors suppliers and consultants. The Code of Business Conduct is available at CAE's Internet website, www.cae.com, in the Corporate Governance section. Amendments to the Code of Business Conduct and waivers, if any, for executive officers will be disclosed on the Registrant's website.

PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following PricewaterhouseCoopers LLP aggregate fees were billed to CAE in each of the years ended March 31, 2003 and 2004 for professional services rendered to CAE:

Fees	2004	2003
	(amounts in millions)	
Audit Fees[1]	$ 2.0	$ 1.2
Audit-Related Fees[2]	0.8	1.2
Tax Fees[3]	0.7	1.0
All Other Fees[4]	0.1	0.4
Total	**$ 3.6**	**$ 3.8**

1 Audit fees comprise professional services for the audit of CAE's annual financial statements, review of CAE's interim financial statements, and services normally provided in connection with CAE's statutory and regulatory filings.

2 Audit-Related Fees comprise amounts paid relating to due diligence in connection with CAE's acquisitions and divestitures.

3 Tax Fees comprise professional services rendered for tax compliance, tax advice and tax planning.

4 All Other Fees comprise amounts paid relating to certification services under certain government obligations.

AUDIT COMMITTEE PRE-APPROVAL POLICIES AND PROCEDURES

CAE's Audit Committee has adopted a pre-approval policy with respect to permitted non-audit services. Under this policy, subject to certain conditions, specified audit-related services, tax compliance, audit services and tax services may be presented to the Audit Committee for pre-approval as a category of services on an annual or project basis. On a quarterly basis, management of CAE is required to update the Audit Committee in respect of the actual amount of fees in comparison to the pre-approved estimate. All non-audit services not otherwise pre-approved by the Audit Committee must be pre-approved by the Audit Committee on an individual basis. Non-audit services for which the estimate of fees does not exceed $75,000 may be approved by the Chairman of the Audit Committee, provided that any such pre-approval is reported to the full Audit Committee at its next meeting.

OFF-BALANCE SHEET ARRANGEMENTS

The disclosure provided under "Off-Balance Sheet Arrangements" on page 24 of Exhibit 3, Management's Discussion and Analysis, is incorporated by reference herein.

CONTRACTUAL OBLIGATIONS

The disclosure provided under "Contractual Obligations" on page 23 of Exhibit 3, Management's Discussion and Analysis, is incorporated by reference herein.

UNDERTAKING AND CONSENT TO SERVICE OF PROCESS

A. Undertaking

CAE Inc. (the "Registrant") undertakes to make available, in person or by telephone, representatives to respond to inquiries made by the staff of the Securities and Exchange Commission ("SEC"), and to furnish promptly, when requested to do so by the SEC staff, information relating to the securities in relation to the obligation to file an annual report on Form 40-F arises or transactions in said securities.

B. Consent to Service of Process

The Registrant has previously filed with the SEC a Form F-X in connection with the Common Shares, including the associated Common Share purchase rights pursuant to the Registrant's Shareholder Rights Plan, which purchase rights trade together with the Common Shares.

SIGNATURES

Pursuant to the requirements of the Exchange Act, the Registrant certifies that it meets all of the requirements for filing on Form 40-F and has duly caused this annual report to be signed on its behalf by the undersigned, thereto duly authorized.

Date: August 11, 2004

CAE INC.

By: /s/ HARTLAND J. A. PATERSON

Name: Hartland J. A. Paterson
Title: Vice President, Legal and General Counsel

EXHIBIT INDEX

Exhibit No.	Description
1	Annual Information Form dated August 11, 2004
2	Audited annual financial statements for the fiscal year ended March 31, 2004
3	Management's Discussion and Analysis for the year ended March 31, 2004
4	Consent of PricewaterhouseCoopers LLP
5	Certificate of D.H. Burney required by Rule 13a-14(a) or Rule 15d-14(a), pursuant to Section 302 of Sarbanes-Oxley Act of 2002
6	Certificate of Paul G. Renaud required by Rule 13a-14(a) or Rule 15d-14(a), pursuant to Section 302 of Sarbanes-Oxley Act of 2002
7	Certificate of D.H. Burney pursuant to 18 U.S.C. Section 1350, as enacted pursuant to Section 906 of Sarbanes-Oxley Act of 2002
8	Certificate of Paul G. Renaud pursuant to 18 U.S.C. Section 1350, as enacted pursuant to Section 906 of Sarbanes-Oxley Act of 2002

QuickLinks

SIGNATURES
EXHIBIT INDEX

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Exhibit 1



ANNUAL INFORMATION FORM
2004

CORPORATE OFFICES
200 BAY STREET
SUITE 3060, P.O. BOX 30
ROYAL BANK PLAZA
TORONTO, ONTARIO M5J 2J1

August 11, 2004

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INFORMATION INCORPORATED BY REFERENCE

The Company's Review of Operations and Management's Discussion and Analysis and its consolidated financial statements for the year ended March 31, 2004, and the notes thereto (the "Consolidated Financial Statements") appear on pages 14 to 28 and pages 30 to 61 respectively in the Annual Report to Shareholders for the year ended March 31, 2004 (the "Annual Report"). The Consolidated Financial Statements were prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP"). For a discussion of the principal difference between Canadian GAAP and the accounting principles generally accepted in the United States, see note 24 to the Consolidated Financial Statements. The information contained therein is specifically incorporated by reference into this Annual Information Form. Any parts of the Annual Report not specifically incorporated by reference do not form part of this Annual Information Form.

Unless otherwise noted, all dollar references in this Annual Information Form are expressed in Canadian dollars.

References to fiscal 2004 refer to the period from April 1, 2003 to March 31, 2004, references to fiscal 2003 refer to the period from April 1, 2002 to March 31, 2003, and references to fiscal 2002 refer to the period from April 1, 2001 to March 31, 2002.

This Annual Information Form contains forward-looking statements with respect to CAE and its subsidiaries based on assumptions that CAE considers reasonable at the time they were prepared. These forward-looking statements, by their nature, necessarily involve risks and uncertainties that could cause actual results to differ materially from those contemplated by the forward-looking statements. CAE cautions the reader that the assumptions regarding future events, many of which are beyond the control of CAE and its subsidiaries, may ultimately prove to be incorrect. Factors that could cause actual results or events to differ materially from current expectations are discussed on pages 15 and 16 of the Annual Report.

ITEM 3 — CORPORATE STRUCTURE OF CAE

3.1 Name, Address and Incorporation

March 17, 1947:	CAE Inc. (the "Company" or "CAE") was incorporated under the name Canadian Aviation Electronics Ltd. under the laws of Canada by letters patent.
July 5, 1965:	The name of the Company was changed to CAE Industries Ltd.
August 3, 1977:	The Company was continued under the Canada Business Corporations Act (the "CBCA") by certificate of continuance.
June 10, 1993:	The Company changed its name to its present one, CAE Inc.

In 1979, the articles of the Company were amended to change its authorized share capital to an unlimited number of common shares. Each issued and outstanding Class A and Class B share was redesignated and changed into three common shares.

In 1981, the Company's articles were again amended to subdivide the issued and outstanding common shares on a three-for-one basis, and to authorize an unlimited number of preferred shares, issuable in series, with such rights, privileges, restrictions and conditions as the directors of the Company may determine by resolution. The articles were amended further in 1984 and 1986, in each case to subdivide the issued and outstanding common shares on a two-for-one basis.

On June 9, 1995, the Company's articles were amended to authorize the directors to appoint additional directors in accordance with the provisions of the CBCA.

On April 1, 2001, the Company was amalgamated with CAE Electronics Ltd., its wholly-owned subsidiary.

The Company's registered offices are located at 200 Bay Street, Suite 3060, Royal Bank Plaza, Toronto, Ontario, M5J 2J1, telephone: (416) 865-0070, fax: (416) 865-0337.

3.2 Inter-corporate Relationships

The direct and indirect subsidiaries and other ownership interests of the Company are set out in Schedule "A" hereto.

ITEM 4 — GENERAL DEVELOPMENT OF THE BUSINESS

4.1(a) General

Following incorporation in 1947, CAE's primary business focused on the repair and overhaul of electronic and electro-mechanical equipment, as well as the design and installation of telecommunication and navigational systems. By the early 1950s, the Company had started to pursue new areas of opportunity in the design, development and manufacture of flight, radar and weapons simulators for Canadian defense requirements. A few years later, CAE began its commercial flight simulation activities.

From the 1960s to the turn of the century, the Company embarked on a program of growth and diversification. CAE acquired several new businesses, both in its traditional aerospace and electronics market segment and in several industrial technology segments. The industrial technology businesses provided a number of diverse engineered products and services for industries worldwide, chiefly those involved in fiber processing technologies (forest products, pulp and paper), cleaning technologies (automotive parts, medical equipment and electronic food processing), and railway technologies and services.

The strategy was significantly changed in fiscal 2000, with the focus turned to the Company's core strengths and key opportunities.

Over the last four years, CAE executed this strategy, divesting itself of its non-core businesses and transforming from being primarily a manufacturer of simulation and controls equipment to also being a provider of fully integrated training in its three core businesses: Civil Simulation and Training, Military Simulation and Training and Marine Controls. The Company is leveraging its technology, expertise and customer relationships acquired in supplying high quality simulation equipment and services to develop integrated training solutions for military forces, commercial airlines, business aircraft operators, aircraft manufacturers and marine vessel operators. Training solutions are customized to meet customers' varied needs for a range of equipment, facilities, training materials, support services and personnel.

4.1(b) History

The transformation of CAE began in fiscal 2000.

In February 2000, the Company announced a "Repositioning for Value" strategy intended to improve shareholder value. The strategy, developed from an intensive review of CAE's core strengths and an analysis of key opportunities, had three main elements:

Focus:	Divesting non-core businesses and concentrating on three high growth, high margin businesses: Commercial Simulation and Training, Military Simulation and Training, and Marine Controls. In December 2001, after achieving success in growing its Civil training business, CAE announced its intention to divest its Forestry Systems Group.
Fix:	A combination of integration, consolidation and productivity measures intended to reduce costs, increase efficiency, and enhance CAE's competitiveness.
Grow:	A series of growth initiatives enabling CAE to expand the scope of its core businesses.

Focus

On May 31, 2000, the Company sold substantially all the assets of its Energy Control Systems business to SNC-Lavalin Group Inc.

On December 18, 2001, the Board of Directors approved a plan to divest CAE's Forestry Systems business segment to further sharpen the Company's focus.

On February 28, 2002, the Company completed the sale of two of CAE's Cleaning Technologies operations. The Company sold CAE Ransohoff Inc., of Cincinnati, Ohio and CAE Ultrasonics, Inc., of Jamestown, New York, to the former management of these operations.

On March 28, 2002, CAE completed the sale of its fiber screening business to the Advanced Fiber Technologies Income Fund.

On June 28, 2002, CAE completed the sale of CAE Cleaning Technologies plc, another of CAE's Cleaning Technologies operations, to the same former management group which previously purchased CAE Ransohoff Inc. and CAE Ultrasonics, Inc.

On August 16, 2002, CAE completed the sale of its sawmill businesses to COE Manufacturing Company.

On April 30, 2003, CAE completed the sale of the operations of CAE Beyss GmbH, another of CAE's Cleaning Technologies businesses, to Bavaria Industriekapital AG.

On May 2, 2003, CAE completed the sale of its wood products business to Carmanah Design and Manufacturing Inc., a TD Capital company.

On July 31, 2003, CAE completed the sale of substantially all the assets of its last remaining Cleaning Technologies business, Alpheus Inc. to Cold Jet Inc. of Cincinnati, Ohio. CAE's focus-driven divestiture program of the past three years is now completed.

Fix

Through a combination of divestments and consolidations, the Company reduced the number of profit centers from 21 to 3, signifying most dramatically how the Company changed the manner in which it manages its businesses.

CAE's Operations and Engineering groups are focused on reducing the cost and production time of commercial simulators while simultaneously improving the product quality.

CAE is investing in software and hardware innovations that will sustain its leading edge technologies as well as complement its training services for CAE training centers and other customers. Examples of such innovation are the Company's next generation simulators, Sim XXI™, its SimFinity™ leading-edge simulation-based courseware, its Tropos™ and Medallion-S™ image generators and its STRIVE™ software development framework to test, model and design military systems during their planning and acquisition phases.

Major corporate functions — finance, human resources, communications and business development — are now fully integrated into the businesses.

Specific productivity goals and cost containment measures are in place each year for each profit center.

Grow

The most significant growth initiatives stem from CAE's investment in pilot training, its increased access to the US and European military markets, and its expansion of the Marine Controls product offering to include the commercial marine sector.

During fiscal 2004 and 2003, CAE completed the integration of its strategic acquisitions made in the prior years:

- Norway-based HiTec Marine Automation AS (HiTec) provides marine navigation products and capabilities for both naval and commercial marine markets. This technology investment complements the Company's existing marine products and capabilities.

- BAE SYSTEMS Flight Simulation and Training Inc. (now called CAE USA Inc.) located in Tampa, Florida, which has a well-established position in the US defense market for the manufacture of transport and helicopter simulation equipment and has significant training and support service activities for the US military market.

- Valmarine AS of Norway (now called CAE Valmarine AS), the global leader for marine control systems for the high-end commercial market.

- the Netherlands-based Schreiner Aviation Training B.V. (now called CAE Aviation Training B.V.), which provides simulator and ground-school civil aviation training through its long-established training centers in Amsterdam and Maastricht, The Netherlands, Brussels, Belgium and Dallas, Texas.

- SimuFlite Training International Inc. (now called CAE SimuFlite Inc.) in Dallas, Texas, the world's second largest provider of business aviation training. At the end of fiscal 2004, SimuFlite had 28 full flight simulators mainly serving the business-aircraft market (the largest addressable or out-sourced aviation training market in the world). CAE views this market segment as one with solid growth potential. It is also a market specifically suited to CAE's new, next generation simulator — Sim XXI™.

In addition to acquisitions, CAE's move into civil aviation and training was further accelerated in fiscal 2004 and 2003 with the following training center initiatives:

- In May 2004, CAE and LAN signed a long-term agreement where CAE will acquire LAN's training facility in Santiago, Chile and address LAN's training needs under a 10-year services agreement. CAE will add two full-flight simulators (FFS) (one Airbus A320 in 2004 and one Boeing 767-300ER in 2005) to the existing Boeing 737-200 full-flight simulator. The A320 device will form part of the CAE-Airbus training cooperative. The total value of the contract, together with third party revenues, is expected to be $40 million.

- CAE and Iberia Airlines signed an agreement to form an aviation training joint venture, consolidating the assets of their respective Spanish training centres — CAE's in Alcala and Iberia's at the Barajas airport. Under the terms of the agreement, CAE will contribute its Alcala assets and Iberia its Barajas assets and related debt to form a new company, where Iberia will train its nearly 2,000 pilots. CAE and Iberia have an 80-20 equity split, respectively. First-year revenues are estimated at $30 million and are expected to increase thereafter, based on Iberia's expected growth and CAE's further development of third-party training opportunities.

- CAE and Airbus entered into a ten-year renewable co-operation agreement to develop a global network of training centers with the largest fleet of Airbus FFS in the world and offering the highest quality of Airbus flight crew training. Under this agreement, CAE is providing equipment, facilities and advanced training technologies while Airbus is providing its courseware and training expertise. The result is a worldwide global network of training centers combining the Miami Airbus facilities with those of CAE in Denver and Toronto, as well as the Toulouse Airbus facilities with those of CAE in Madrid, Brussels, Rome, Dubai, Singapore and Sao Paulo. CAE is responsible for adding flight simulators and related training technologies in line with Airbus standards and expanding the global network according to market demand. This network is offering the whole range of integrated training solutions, from simulator availability to complete training for initial, recurrent, transition and specialty training.

- To reflect the tangible benefits derived from the Cooperation Agreement signed between CAE and Airbus in August 2002, CAE signed in the second quarter of fiscal 2004 a contract with Airbus for the development of the world's first A380 FFS. CAE will provide a complete range of training devices for the A380, including two FFS equipped with the CAE Tropos™ visual system and CAE Simfinity™ software licenses for desktop and laptop trainers for $55 million. The first simulator will be sent to Airbus's Toulouse training center in early calendar 2005. In addition, CAE and Airbus have joined forces to offer Airbus Corporate Jetliner ("ACJ") enhanced training courses. ACJ customers will now have access to training at 10 sites worldwide, including for the first time ever, four sites in North America.

- In July 2004, CAE and Qantas signed a contract for a suite of Airbus A380 integrated training solutions, including an FFS and a CAE Simfinity™ training device. The training equipment package is valued at about $25 million and delivery of the FFS is slated for summer 2006.

- The Denver, Colorado facility became operational in July 2002. The four-bay center is currently operating four simulators: an Airbus A320, two Bombardier CRJ200/700 and a CRJ200. The Denver center is strategically located close to the country's sixth busiest airport and is the first independent training center in the US for Bombardier CRJ700 regional jets. Two airlines are the anchor tenants in the new facility: Frontier Airlines and Air Wisconsin. The two carriers have committed to long-term training agreements of 5 years and 15 years, respectively. Other current customers include Horizon Air and over-flow training from Mesa Air Group.

- CAE's training facility near Phoenix, Arizona became operational in March 2003, and the Company signed a 10-year training contract with Mesa Air Group for services at that center. CAE is providing training solutions to Mesa, primarily in support of the airline's fleet of Bombardier CRJ and Embraer ERJ-145 aircraft. The contract is worth approximately $50 million, based on expected usage of the simulators. CAE has installed a Bombardier CRJ200/700/900 FFS and an Embraer ERJ-145 FFS in the two-bay facility. With this new facility, CAE became the first independent training provider for the new CRJ900 regional jet. The contract with Mesa also includes CAE's SimFinity™ CRJ200/700/900 Integrated Procedure Trainer, the latest high-fidelity SimFinity™ three-dimensional training solution.

- CAE and China Southern Airlines announced in November 2002 the formation of a joint venture to provide aviation-training solutions for Asian carriers. The joint venture company, Zhuhai Xiang Yi Aviation Technology Company Limited, is owned 51% by China Southern and 49% by CAE and is operating from China Southern's training facility at its Zhuhai flight base in Guangdong. It is focused on developing and delivering high technology training solutions for aviation, initially offering simulation-based pilot training and other technical services for carriers operating Boeing 737NG, 737-300, 777, 757-200 and Airbus A320 aircraft. To continue their fifteen-year relationship, CAE and China Southern Airlines announced the addition of an Airbus A321 FFS to the Zhuhai Xiang Yi Aviation Technology training center in Zhuhai, Guangdong province, China last December. Training on this simulator will begin in the fall of 2004.

- In operation since June 2002, Emirates-CAE Flight Training Center resulted from a July 2001 teaming agreement between Emirates Airline and CAE. Currently located in the Dubai Airport Free Zone, the center expanded into a new 14 bay-facility in fiscal 2004 and includes Airbus A319/A320/A321, Airbus A330/340, Boeing 737 NG/BBJ, Gulfstream IV and Gulfstream V FFS and a convertible Hawker 800/800XP FFS. In December 2003, it was announced that a second Boeing 737NG/BBJ simulator and a Bell 412 helicopter FFS would be added to the Dubai facility. During the Farnborough air show in early June 2004, CAE secured a competed order from Dubai's Emirates airline for three full-flight simulators; two Airbus A380-800s and one Airbus A340-600, giving CAE four simulator orders to date in fiscal year 2005. The contract is valued at approximately $65 million. Under the terms of the agreement, CAE will also become Emirates' exclusive provider of FFS for 10 years. Emirates Airline has already purchased five CAE FFS for its flight crew training. The Dubai center is offering the highest standard in aviation training and facilities in the region for both airlines and corporate aircraft operators. It trains pilots to European Joint Aviation Authorities (JAA) and UAE GCAA standards on CAE-designed FFS. Emirates-CAE Flight Training is equipped with the industry's latest integrated training technologies including CAE's SimFinity™ classroom trainer and convertible A320/B737 Integrated Procedures Trainer.

- CAE's Amsterdam center in April 2003 launched maintenance training courses using CAE's SimFinity™ training system, following approval from the European JAA. Maintenance training for technicians is a requirement of all JAA-regulated countries. This furthers CAE's goal to address a growing portion of the total aviation training market — aircraft maintenance. The Amsterdam center has signed maintenance training agreements with KLM Royal Dutch Airlines, Moscow-based Transaero and Netherlands-based Samco. The highly interactive training will use CAE's SimFinity™ virtual maintenance trainer to familiarize students with aircraft systems and teach them procedural and troubleshooting skills.

CAE has experienced significant successes in military simulation and training in recent fiscal years:

- On July 22, 2004, CAE-led Landmark Training Ltd. was selected as the intended preferred bidder for the British Army's Armoured Vehicles Training Service (AVTS) program. The AVTS program, valued at approximately £1.0 billion ($2.4 billion) over 30 years, is a private finance initiative designed to provide turnkey driver, gunnery and command information systems training to crews of armoured fighting vehicles. Landmark Training Ltd. is owned 65% by CAE, 25% by AgustaWestland, and 10% by Interserve.

- In June 2003, CAE announced the creation of a consortium "Rotorsim", owned equally by CAE and Agusta S.p.A., to operate a new helicopter training facility in Italy and to provide integrated training solutions for Agusta Westland helicopters. The Rotorsim facility will open in 2005 with the delivery of a CAE-built A109 full mission simulator (FMS) and is expected to generate revenues of $125 million over 15 years. Training for additional Agusta Westland platforms will be added in the future. CAE has since signed a $7.8 million contract with Agusta S.p.A. for an upgrade to the Italian army's A129 helicopter flight simulator located at the army-training base in Viterbo, Italy. CAE will provide its CAE Medallion-S™ image generator as part of the upgrade program.

- On July 17, 2000, CAE's Medium Support Helicopter Aircrew Training Facility (MSHATF) officially opened at Royal Air Force (RAF) Base Benson in Oxfordshire. The facility is the product of a highly innovative, 20 year, private finance initiative contract with the UK MoD. Payment is based on a guaranteed minimum usage and also allows for third party usage. Currently third party training is being provided to the Air Forces of The Netherlands, Republic of Singapore, Canada and others. The facility provides training to the RAF and third party customers on the Eurocopter Puma, Boeing CH-47 Chinook, and EHI EH-101 Merlin helicopters. The MSHATF is equipped with six CAE-built FMS, four computer-based training classrooms, and a state-of-the-art tactical control center to plan and monitor training missions. It is staffed with a team of highly experienced former military instructors.

- As a demonstration of the UK Ministry of Defense (MoD) and CAE's commitment to offer and maintain high level of quality for training services, CAE was awarded during fiscal 2004 by the MoD a contract valued in excess of $9 million to upgrade the Medium Support Helicopter Aircrew Training Facility (MSHATF), combined with another contract valued at more than $3 million to provide initial and recurrent training to CH-149 Cormorant helicopter aircrews.

- In July 2002, CAE was selected as one of several prime contractors under the United States Air Force (USAF) Training Systems Acquisition II contract. This permits CAE to pursue USAF, Air Force Reserve, Air National Guard and Foreign Military Sale products and services programs. During the fourth quarter of fiscal 2002, CAE signed a contract with the US Army to be the prime contractor for the Army Special Operations Forces Aviation Training and Rehearsal Systems (ASTARS). The initial delivery order, valued at approximately $50 million, is for the design of the world's first AH/MH-6 Light Assault/Attack Reconfigurable (LASAR) Combat Mission Simulator to train aircrews of both the AH-6 and MH-6 helicopters. The helicopter simulator, which will feature a 24-foot dome display, will be used by the US Army 160th Special Operations Aviation Regiment (SOAR), the elite regiment of soldiers known as the "Night Stalkers", who have played a key role in Afghanistan and Iraq. As prime contractor for the ASTARS program, CAE is analyzing the training and simulation needs of the US Army 160th SOAR and assisting in the development of upgrades to existing systems and new training systems. This contract enhances CAE's prospects for securing other US military contracts at a time when military spending has been on the rise.

The latest point underscores the close relationships CAE has established in the US military market.

In addition to its Valmarine acquisition, CAE has ratified significant contracts in its Marine controls segment:

- During the second quarter of fiscal 2002, the FAST Consortium, controlled by CAE and half by Alenia Marconi Systems, signed a contract with the Defence Procurement Agency of the UK Ministry of Defence for the Astute Class Submarine Training program. This Private Finance Initiative contract is for the provision of comprehensive training services to the Royal Navy for 30 years, with an option to renew for an additional 10 years, in the operation and maintenance of the Astute Class submarines. A new training center is being built in Scotland to house the simulators and provide classroom-training facilities. The contract added over $400 million to the Company's backlog and complements the other growth initiatives in the Marine Controls segment.

- In July 2004, the FAST Consortium agreed to the terms of an amendment increasing the value of its existing contract with the U.K. Ministry of Defence (MoD) by approximately $445.0 million for the Astute Class Training Service. The value to CAE of this amendment is more than $0.2 billion, based on the guaranteed level of training requirements from the MoD and potential subcontracts.

4.1(c) Industry Overview and Trends

The civil, military and marine markets CAE serves are driven by factors particular to each market. CAE believes the civil market is most affected by the nature and composition of aircraft fleets, pilot demographics, certification requirements and market demand for commercial and business air travel. The Company believes the military market is most influenced by a combination of defense spending and the nature of military activity. CAE believes the marine markets the Company targets are, on the naval side, affected by a combination of defense spending and the nature of naval activity and on the civil side by the nature and composition of commercial fleets and market demand for commercial marine shipping and tourism.

4.1(d) Civil Simulation and Training

The use of flight simulators in pilot and crew training is well established within the commercial and business markets. Increased use of simulators has occurred as a result of the growth in commercial and business air travel which, in turn, has driven fleet expansion and increased demand for pilot training. Civil simulator usage has also increased due to advances in technology that enable increased realism and the significant cost savings provided by flight simulation training compared to actual flight time. The use of synthetically-generated reproductions of airport configurations and use of satellite terrain imagery incorporated into the simulation further enhance the effectiveness of simulation training. Simulators are also utilized by pilots to supplement actual flying time to maintain their certification. Today's most sophisticated civil flight simulators are rated Level D by the US Federal Aviation Administration or receive similar ratings from regulatory authorities in other countries, indicating that a pilot can be certified to fly an aircraft type based solely on simulator training. Flight simulators also allow pilots to experience and learn emergency procedures that cannot be practiced safely aboard the actual aircraft.

Flight simulation equipment is purchased by major and regional airlines, aircraft manufacturers and independent training providers. Simulators are manufactured by a limited number of companies and are sold based on the criteria of product quality, service, delivery, supplier reputation, price and life cycle costs. In fiscal 2004, 16 FFS were sold to third parties in the global competed market, in which contracts are awarded on the basis of a competitive bidding process. Prices for civil flight simulation equipment can range from up to $1 million for sophisticated procedure trainers, from US$2 to US$6 million for a flight training device (FTD's) to US$12 to US$14 million for an FFS.

Within the flight simulation industry, training services is the largest and fastest growing market segment. The training services market consists of sales of training equipment, facilities, tools, programs, and instructors designed to enable pilots to obtain and retain the necessary qualifications to pilot a particular aircraft, and to enable maintenance workers to inspect, maintain and repair aircraft. Training is carried out by airlines as well as independent training providers. Currently, approximately half of the FFS in use around the world are owned and operated by commercial airlines to provide training to their pilots, with the vast majority owned by large commercial airlines. These large commercial airlines also use independent training facilities to supplement their training programs. Ownership of simulators by regional airlines is considerably less common and virtually not the case for business aircraft operators. As a result these companies primarily use independent training providers.

CAE believes the following trends and developments will continue to drive the civil simulation and training industry:

Effectiveness and Cost Advantages of Simulation-Based Training

Simulation-based training is an essential element in civil pilot and crew training. The realism of the simulated flight experience has made procedure trainers, fixed training devices and full flight simulators effective tools for training pilots and crew. Pilots and crew can be trained for a variety of aircraft, using visualizations of most of the civil airports around the world, and in varying environmental conditions. The cost savings to aircraft operators are substantial as it is five to ten times cheaper to train in a simulator than in a civil aircraft. In addition, simulator training minimizes the risk of accidents and resulting injury to personnel and damage to equipment. Full flight simulator training users are also accorded more favorable liability insurance premiums. Simulator-based training also offers considerable flexibility with respect to the timing and duration of training sessions. In the past, the use of independent training services was limited by the availability of convenient training centers. With the development of additional independent training centers around the world, CAE believes that this historical deterrent will be addressed. CAE believes that the costs of acquiring and maintaining FFS will encourage additional usage of independent training providers by commercial airlines.

Pilot Certification and License Requirements

Piloting an aircraft is a regulated activity requiring both initial and recurring training to achieve defined levels of competence and experience. To keep a license to fly an aircraft weighing over 12,500 pounds, certain regulations require pilots to demonstrate proficiency for that aircraft type at least once a year. Certification and license requirements can be satisfied through simulated flight and many pilots elect to do so.

Expansion and Diversification of Aircraft Fleets

The introduction of new aircraft and expansion and diversification of fleets creates incremental pilot training requirements. Simulation training is now considered an essential element in pilot and crew training for the large commercial, regional and business segments of the market. An experienced pilot typically needs between 15 and 40 hours on a simulator to learn the intricacies of a new aircraft. CAE estimates that approximately one simulator is required to support every 20 wide-bodied commercial aircraft in operation, with that ratio changing to one for 40 regional jets and one for 80 business aircrafts.

New aircraft deliveries are a major driver for this market. In "The World Market for Large Commercial Jet Transports", Forecast International/DMS Inc. projects that 5,835 large commercial jet transports worth some US$545 billion will be produced from 2004 to 2013.

Demand for civil air travel and the timing of delivery of new aircraft were adversely affected by the September 11, 2001 terrorist attacks and the ensuing war in Afghanistan. In fiscal 2004, that demand and timing was compounded by the SARS epidemic and the increasing geo-political tensions that resulted in war on Iraq. As a result, aircraft orders suffered and CAE experienced a reduction in new third party orders for full flight simulators. The market uncertainty caused by these events had a very negative effect on commercial airlines, aircraft manufacturers and, by extension, CAE, which is somewhat dependent on the health and success of those industries. However, the impact of these events has been less severe on the demand for flight training services as pilots still need to be trained.

Virtually every business aircraft transaction, whether a new or after-market transaction, triggers the need for pilot training. Business aircraft simulation training is provided by independent training providers. CAE believes that additional demand for business aircraft simulation training will be driven by growth in new business aircraft sales — 10,809 are forecast to be produced between 2004 and 2013 — and the increase in fractional ownership and unscheduled charter flights. Long-term growth in civil air travel will drive increased aircraft deliveries across the spectrum of aviation service providers and, in turn, the demand for simulation technology and training.

Pilot Demographics

According to AIR Inc., a major pilot recruitment firm, US-established airlines will retire more than 11,000 pilots over the next five years. They also estimate that between 6,500 and 9,000 new pilots will be hired in 2004. As pilots retire, other pilots must be trained to fly the aircraft. Historically, the major commercial airlines hired a substantial number of pilots from the military as these pilots retired or otherwise left military service. In recent years, there have been fewer available military pilots. The relative lack of available military pilots has caused increased demand for qualified pilots throughout the industry. As a result, the major airlines have begun to more actively promote pilots to larger aircraft from within their existing ranks or from regional airlines operating smaller aircraft. This increased mobility within a fleet results in more pilots needing to be certified on different aircraft and a corresponding increase in training requirements.

Other Factors

The September 11, 2001 terrorist attacks had an immediate and severe adverse impact on the passenger traffic and yields of CAE's customers in the civil airline industry. Even as the after-effect on the industry of the shock of that event and the subsequent war in Afghanistan were receding, the more recent SARS epidemic and Iraqi war again caused a sharp drop-off in commercial travel coupled with higher fuel and other costs. Civil airline operators have continued to experience significantly lower revenue and have incurred additional costs for increased security and higher insurance premiums. Because of these events, resulting airline bankruptcies and funding problems and continuing weak domestic and international economic conditions, CAE expects that the delivery of new aircraft will continue to be low through the first half of fiscal 2005, and should increase thereafter.

The US government has developed regulations that require any non-US person to apply for permission to enter the US for the purpose of flight training. These regulations delay and insome instances prevent the ability of foreign pilots to enter the US for flight training, which has had a mildly negative near term effect on CAE's training business in the US. This is being partly offset by relocation of some non-US pilot training to CAE's flight training centers outside of the US.

4.1(e) Military Simulation and Training

Military forces increasingly rely on sophisticated and interrelated weapons systems and equipment, computer systems, visual systems and other advanced technologies to operate in a broadening range of conditions and scenarios. Achieving a high state of operational readiness is a constant goal and challenge for militaries. Simulators enable military organizations to achieve their training goals while minimizing the physical use of expensive systems and equipment. In addition, the use of simulators helps to avoid injuries to personnel and the loss of equipment due to training accidents. Simulators allow for the training of tasks and missions that cannot be practiced in the real world.

Flight simulators are used to train pilots to operate a variety of military aircraft including fighter jets, helicopters and transport aircraft. Flight simulators permit the crews of military aircraft to coordinate and improve their essential combat skills in a safe, cost-effective and realistic range of environments. It is fifteen to twenty-five times cheaper to train in a simulator than in a military aircraft. The simulators enable pilots to realistically practice both offensive and defensive tactics, such as firing aircraft weapons systems and avoiding attack from enemy surface and air threats. The immersive environment provided by simulators allows pilots to train for highly demanding maneuvers and life threatening scenarios, such as rotor failure, missile impact or the effects of exceptional turbulence.

Simulators for land systems provide similar advantages. Though land systems equipment is generally less complex than that found in aircraft and marine vessels, the systems often operate in conjunction with other equipment in environments involving many soldiers and various weapons systems.

CAE believes the following trends will continue to drive the development of the military simulation and training market:

Increasing Defense Spending

Following the September 11, 2001 terrorist attacks, the US government increased its defense spending. The fiscal 2004 national defense budget in the US was more than US$401 billion, which does not include additional funding requested to support the war effort in Iraq. In fiscal 2005, the US defense budget is expected to be more than US$447 billion. The US government's defense spending has recently represented about 40-50% of the world's total defense spending and this is expected to continue through this decade. Military spending is also increasing in Asia, while defense expenditures are stable in NATO countries other than the US. Apart from spending on defense, there is an increased emphasis on security in most Western nations in the face of increased terrorist threats. CAE expects that some of this spending will address new technologies and training for counter-terrorism activities.

Rapid Evolution of Technology and Warfare

Technological advances and the changing nature of warfare have resulted in a rapid evolution of weapons systems and equipment. This has been illustrated by recent events in Afghanistan and Iraq, where the coalition forces faced asymmetric threats and where extensive use was made of unmanned air vehicles (UAV) such as the Predator and Global Hawk. Military forces face a wide range of operations which are increasingly likely to be asymmetric or involve operations in urban terrain. In light of these changing circumstances, the key focus of military forces has evolved towards information dominance linked with networked weapons systems. These highly technical networked systems lend themselves to simulation training.

Accelerated developments in computer and visual technologies enable devices of greater fidelity and promote the proliferation of simulation technologies. In particular, the rapid evolution of commodity graphics technologies of recent years has substantially redefined the price/performance envelope of visual equipment. Visual systems provide simulator-correlated, geo-specific representations of the synthetically generated environment under a broad range of weather, illumination and other conditions. Visual database representations can be rapidly synthesized from the Geographical Information System, including satellite data, and applied to military mission rehearsal exercises.

The introduction of new aircraft and weapons platforms, as well as upgrades and life extensions to existing aircraft and weapons platforms will necessitate new training requirements for military operators. For example, CAE expects programs in Europe such as the Eurofighter 2000, the A400M military airlifter, the NH90 helicopters as well as upgrades for the Tornado tactical aircraft and Lynx helicopter fleets will create additional flight simulation requirements. The USAF upgrade of its C-130 fleet under the Avionics Modernization Program will also require corresponding upgrades and new simulators to train aircrews on upgraded aircraft. Other aircraft such as the F-35 (Joint Strike Fighter) and US Navy's Multi-mission Maritime Aircraft will also enter service in the US over the next decade and produce opportunities for training systems. CAE is actively pursuing these opportunities.

Evolving Role of Simulation Training

CAE believes that the military will continue to make greater use of simulation as an effective solution for more frequent and sophisticated training requirements for several reasons. First, advances in technology have enhanced the realism that can be achieved in simulation training. As a result, militaries are more receptive to utilizing this technology. The achieved realism combined with the development of extensive environment databases offer militaries the ability to train in situations and conditions either difficult or impossible to consistently replicate in a physical setting. Second, simulation training also is more cost effective (up to 25 times cheaper) than training personnel on actual equipment. Third, simulation training involves less potential for accidents and resulting injury to personnel and damage to equipment. Finally, CAE believes simulation will increasingly be used in areas consistent with the Simulation Based Acquisition initiatives of the US Department of Defense which seek to use simulation to evaluate competing system designs prior to commitment to full scale design and development.

Increasing Interest of Governments in Privately Financed Long-Term Training Models

The increasing sophistication of weapons systems has resulted in the need for more sophisticated training equipment and services. The development, construction and delivery of these training resources require a high level of specialized technology and knowledge, and often involve significant expense. The UK government has increasingly turned to private sector companies to build, maintain and deliver training equipment and services under long-term private financed initiatives (PFI) because these companies can deliver an integrated training solution more quickly and efficiently and at lower cost. CAE is already in full scale operation in the UK's first military training PFI, the Medium Support Helicopter Aircrew Training Facility. The CAE-led Landmark Training consortium, which is owned 65% by CAE, has been selected as the preferred bidder for the British Army's Armoured Vehicles Training Service program, a PFI program valued at approximately £1 billion over 30 years.

CAE's Marine division's 36 year PFI program through the FAST Consortium is further evidence of the UK's commitment both to PFIs and CAE's technology and superior service capabilities, worth nearly $600 million to CAE based on guaranteed training levels over the contract term.

4.1(f) Marine Controls

Integrated shipboard control systems installed on naval and civil ships enable crews to monitor and control the vital platform machinery and systems such as propulsion, electrical power generation and distribution, steering, auxiliaries and damage control. The operational effectiveness of a ship is greatly enhanced by incorporating on-board control systems training capability. Operators can be continuously trained while at sea using these systems. This facilitates high levels of fleet readiness to respond to demands of national security for naval ships and facilitates enhanced passenger comfort and safety in civil applications such as cruise liners.

Simulators for submarines and other naval vessels provide many of the same training advantages as flight simulators. Crews of submarines are able to coordinate and improve their essential combat and operational skills, including navigation, weapons deployment, mission skills and speed in processing critical data in a safe, cost-effective and realistic range of environments. Such simulators are used to train crews for highly demanding maneuvers and life threatening scenarios, such as catastrophic structure failure and missile impact. Other simulators for naval control systems permit a crew to learn to operate a ship's control systems in a variety of environments.

CAE delivers power simulator solutions that best suit the Company's customers' training or engineering needs whether the plant to be simulated is nuclear, fossil or natural gas fired plant. CAE simulators range from classroom training simulators to system trainers to full-scale simulators. Operators can enhance their skills to ensure safer, as well as more efficient plant operation, thereby addressing the ever-changing demands of both the marketplace and regulatory bodies.

CAE believes the following trends will continue to drive the development of the marine controls and power markets:

Increasing Complexity of Ship Designs and Reduced Manpower

CAE believes that new ship designs will continue to steadily increase in complexity and value with the commensurate demand for more sophisticated control systems and integration solutions. At the same time, the need for navies and civil ship owners/operators to reduce operational costs by reducing manpower on-board ships adds to the demand for complex automation. The potential reduction of engineering manpower is of particular interest to those navies that face manpower retention problems due to long periods at sea. The evolution to ever more complex automation creates both a manufacturing and a training opportunity for suppliers like CAE.

Integrated Procurement

There is a trend towards the procurement of larger turnkey packages of ship controls and associated electronic/electrical systems by navies, owners of high-end merchant ships and shipbuilders around the world. This should allow companies with the capability to undertake such larger scale integration tasks to win contracts of greater value, with the attendant long-term benefits that will accrue due to the requirement to support these ships typically for over 20 years.

Power Plant Modernizations

Power plant modernizations and new DCS-based controls are but some of the changes affecting the need for simulation solutions. The power industry has also experienced an aging workforce that will ultimately result in the retirements of numerous experienced power plant personnel. Along with the exciting technological advances, the power industry is also coming to grips with the important role that simulation technology will play in both provision of licensed operator training and "beyond training" uses, including procedures validation, engineering studies and virtual testing of power plant updates prior to their actually going into service.

4.2 Significant Acquisitions

There were no significant acquisitions made during the most recently completed financial year.

ITEM 5 — NARRATIVE DESCRIPTION OF THE BUSINESS

5.1 General

CAE is a world leading designer and manufacturer of advanced simulation and control equipment and provider of integrated training solutions for the military, civil aviation and marine markets. With over 50 years of experience, strong technical capabilities, a highly trained workforce and a global reach, CAE has built an excellent reputation and long-standing customer relationships.

CAE has delivered simulation products to the military forces of more than 30 countries. The Company is the world's leading supplier of civil flight simulators in the competed market and is the second largest independent provider of civil aviation and training services based on the number of simulators operated. CAE is a world leader in the provision of marine automation systems for both naval and commercial shipping and supplies full scope simulators to support the training of staff for both nuclear and fossil-fueled power generation plants. CAE also provides a range of simulation equipment for sea and land-based activities.

CAE also provides a range of technical support services to civil and military simulator operators, including parts replacement and repairs, installations, relocations, upgrades and technical training. Customers use the Company's technical services to answer questions, trouble-shoot and receive advice. This extends to service visits by CAE's engineers to assist in customer maintenance and repair activities. Military and civil upgrade services are not restricted to CAE products; the Company can upgrade most other manufacturers' simulators. CAE services are offered either in conjunction with a sale of a simulator, through maintenance contracts or individual purchase orders. CAE believes that its service business provides opportunities to influence the upgrade of installed simulators while providing valuable insights into customer training needs.

CAE has a global presence with more than 5,500 employees at manufacturing operations and training facilities in 19 countries on five continents. CAE reports results based on three business segments: (i) Civil Simulation and Training; (ii) Military Simulation and Training; and (iii) Marine Controls. The Company's consolidated revenue from continuing operations in fiscal 2003 and 2004 was $1,130.5 and $1,093.2 million, respectively, and is broken down as follows:

Revenue by Product Line (%)

	2004	2003
Civil Simulation and Training	42	46
Military Simulation and Training	43	39
Marine Controls	15	15
	100	**100**

Geographic Distribution of Revenue (%)

	2004	2003
Canada	12	8
US	31	29
UK	10	13
Germany	13	11
Other European countries	16	14
Other countries	18	25
	100	**100**

For the fiscal year ended March 31, 2004, sales to customers outside the US and Canada accounted for approximately 57% of CAE's revenue. The Company expects that sales outside the US and Canada will continue to account for a significant portion of its revenue for the foreseeable future. As a result, CAE is subject to risks of doing business internationally, including:

- changes to regulatory requirements;
- changes to domestic and foreign government policies, including requirements to expend a portion of program funds locally and governmental industrial cooperation requirements;
- the complexity and necessity of using foreign representatives and consultants;
- imposition of tariffs or embargoes, export controls, including US, Canadian and foreign arms export controls, currency exchange controls and restrictions, and other trade restrictions affecting countries in which CAE sells its products or services;

- the difficulty of managing and operating an enterprise spread over various countries;
- compliance with a variety of foreign laws; and
- general economic and geopolitical conditions, including international hostilities, inflation, trade relationships and military and political alliances.

The impact of these factors is difficult to predict and any one or more of these factors could adversely affect the Company's operations in the future.

CAE deals with a variety of goods and services suppliers across its business segments. It is not dependent on any single supplier for any key manufacturing components or services. Significant shortages of goods and services are not expected, and have not been encountered in the past. However, CAE's products contain sophisticated computer systems that run on software and operating systems supplied to it by third parties. Such computer systems and software may not always be available to CAE to license or purchase. The production of CAE simulators is often dependent upon receipt by CAE of data, including confidential or proprietary data, concerning the functions, design and performance characteristics of a product or system, the performance of which CAE's simulator is intended to simulate. The Company cannot guarantee that it will be able to obtain such data on reasonable terms, or at all. Original manufacturers of these products and systems could object to the simulation by CAE of components of, or the totality of their products or systems, or could request high license fees that could negatively impact the Company's profit margins.

The following sets out, by business segment, the locations of CAE's primary subsidiaries and divisions:

CIVIL SIMULATION AND TRAINING	*MILITARY SIMULATION AND TRAINING*	*MARINE CONTROLS*
Canada • Montreal, Quebec • Toronto, Ontario	***Canada*** • Montreal, Quebec	***Canada*** • Montreal, Quebec
United States • Dallas, Texas • Denver, Colorado • Fort Worth, Texas	***United States*** •Tampa, Florida	***United States*** •Leesburg, Virginiacfn>
Europe • Amsterdam, The Netherlands • Brussels, Belgium • Madrid, Spain • Maastricht, The Netherlands • Evora, Portugal	***Europe*** • Burgess Hill, United Kingdom • Royal Air Force base, Oxfordshire, United Kingdom • Stolberg, Germany	***Europe*** • Barrow, United Kingdom • Burgess Hill, United Kingdom • Drammen, Norway
Other • Dubai, United Arab Emirates • Sao Paulo, Brazil • Santiago, Chile • Zhuhai Guangdong, China	***Other*** • Adelaide and Silverwater, Australia	***Other*** • Bangalore, India

5.1(a) Summary of Business Segment

Civil Simulation and Training

The Company builds civil simulators for all categories of aircraft including those built by Airbus, Boeing, Bombardier, Cessna, Dassault, Embraer, Fairchild/Dornier, Gulfstream and Raytheon. CAE also builds simulators for civil helicopters, including models by Bell Helicopter and Sikorsky. During fiscal 2004, CAE was awarded 16 of 19 full flight simulator orders or 84% of the worldwide-competed market (fiscal 2003 — 11 of 17 full flight simulator orders). CAE also captured 16 of 20 competed visual systems, or 80% of the worldwide competed visual systems market. Since its inception, CAE has taken orders for approximately 500 full flight simulators and flight training devices from over 100 commercial airlines, aircraft manufacturers and external training centers in 38 countries, and to date has delivered about 480 of them. With half a century of experience in designing and manufacturing full flight simulators, CAE has established long-standing relationships with leading commercial airlines throughout the world. CAE believes its ability to maintain its global leadership is strengthened by the capital and technology intensive nature of the industry, which creates substantial barriers for new entrants.

In 2001, CAE entered the civil flight training business by opening its first pilot training center in Sao Paulo, Brazil in April and launching its Toronto, Canada facility in December. During 2001, the Company also acquired Schreiner and SimuFlite, adding six new pilot training centers to its operations. CAE is the world's second largest independent provider of training services, based on the number of simulators available for third party training. As at March 31, 2004, CAE had an installed base of 102 civil full flight simulators in more than 21 locations on four continents.

CAE intends to continue to expand its global network of strategically located training centers. The Company's practice is to secure at least one long-term training agreement with a major or regional airline prior to establishing a new civil training center. CAE's customers at the commercial aviation training centers include major and regional airlines that elect to outsource some of the training of their pilots and other crew members using either the Company's training instructors or their own. The third party aviation training centers are used by more than 3,000 customers who tend to use third party training centers as their primary source for simulation training. CAE will continue to execute its pilot training strategy, with the focus now ramping up utilization and increasing yield (through enhanced service offerings) in the training centers owned or operated by CAE.

CAE expects to maintain a commanding leadership position in civil simulation and visual systems due to a focus on customer relationships, commitment to innovation and technology, product quality, reliability and efficiency, and continuing efforts to shorten delivery cycles through process improvements. CAE expects to increase its advantage in lead-time, cost, quality and reputation for performance through operational improvements and research and development programs. Four years ago, CAE launched a large-scale research and development program to improve flight simulator products. CAE's Sim XXI™ modular design is the result of the latest next-generation technologies used to produce high quality high fidelity full flight simulators. The CAE Sim XXI™ simulator is easier to assemble, test, integrate, evaluate, deliver and maintain. In fiscal 2003, CAE entered into production of these simulators, which are in the process of acceptance testing by customers. In fiscal 2004, Civil's investment in CAE Sim XXI™ was validated. Both Europe's Joint Aviation Authorities and the US Federal Aviation Administration ("FAA") approved in November 2003 the first CAE Sim XXI™ level D-qualified simulator, a Gulfstream IV FFS located in the Emirates-CAE flight training centre. This first qualification was soon followed by others, a Gulfstream V FFS also located in Dubai, and a Boeing 737-800 FFS, this time level D-qualified by the UK's Civil Aviation Authority, located in Ryan Air's East Midlands Airport training facility. While CAE's Sim XXI™ simulators were originally targeted at the regional and business jet training mandates, CAE has now extended this technology to commercial aircraft.

In fiscal 2004, Jet Blue Airways awarded CAE an $85 million contract, one of CAE's largest-ever order for FFS, for the manufacture of six FFS, and selected CAE as its exclusive supplier for a period of 10 years. In addition, on July 15, 2004, Jet Blue Airways ordered more training devices from the CAE Simfinity line of products and services for a value of $11 million.

CAE's capabilities in simulation-based interactive learning, including its leading-edge SimFinity™ system, will also complement its traditional strength in full flight simulators and flight training devices. In fiscal 2003, CAE's SimFinity™ training system received its first US Federal Aviation Administration acceptance as part of a Boeing 737NG training program, and level 4 qualifications for CAE's Bombardier CRJ 200 IPT used as part of Atlantic Coast Airline's training program. In fiscal 2004, Transport Canada qualified CAE's convertible Dash 8-100/300 CRJ 100/200 IPT as a Level 4 training device. By using the same high quality simulation software used in CAE's full flight simulators, CAE's SimFinity™ training system is transforming aviation training and offers integrated, efficient and cost-effective solutions to meet the ever-increasing needs for better, faster and more interactive training while significantly reducing the need to use low-level training devices. CAE's SimFinity™ training system integrates CAE's newest image generator, Tropos™, for high-fidelity visual rendering and an extensive airport database library. Pilots using CAE's SimFinity™ training system are able to practice landing, takeoff and taxiing under different weather conditions in over 250 airports. Combined with a growing network of training centers, this complete suite of simulation-based equipment and training products permits CAE to offer airlines and business jet operators a range of training solutions.

The events of September 11, 2001, the Afghan war, SARs and the Iraqi war all had a negative impact on commercial airlines, on aircraft manufacturers and, by extension, on CAE, which to some degree is dependent on the health and success of those industries. CAE experienced considerable softening of near-term demand for civil simulators in the last two years but experienced increases in simulator orders in fiscal 2004 to exceed last year's level. This increase is supported by fiscal 2005 orders secured of five out of six competed FFS orders from April to July 2004. The contracting market for civil simulators last year led to pricing pressure that CAE expects may continue until the market becomes more robust. In addition, following the Company's entry into the civil aviation training market, the market for new simulators for sale to third parties has been reduced, as CAE now manufactures these for its own use. The growth expected from training operations, the building of simulators for the Company's training centers as well as for sale, the introduction of CAE's Sim XXI™ simulator design, a continued focus on productivity savings through cycle time reductions and other cost containment initiatives should position CAE to benefit from the gradual recovery of the civil airline industry.

Military Simulation and Training

CAE is a world leader in the design and production of military flight simulation equipment. The Company develops simulation equipment and training for a variety of military aircraft, including fighter jets, helicopters and transport planes. Its military simulators provide full combat environments that include interactive enemy and friendly players, as well as weapons and military sensors. These simulators incorporate highly realistic visual scenes covering areas as large as whole countries that are able to show the effects and characteristics of a variety of battlefield features, including those seen through Infra Red and Low Light Level TV Sensors. CAE has moved beyond the supply of simulation equipment into the provision of military training with the Company's Medium Support Helicopter Aircrew Training Facility in the UK and its C-130 transport plane training facility in Tampa, Florida.

CAE provides simulation equipment and training to the military forces of more than 30 countries, including those of the US. CAE has provided simulators for a wide range of aircraft and has developed the broadest rotary wing expertise of any simulator manufacturer. The Company has established a leading position in Europe in the supply of army command team land-based training systems, by supplying such systems to the forces of Germany, Austria, Italy, Norway, Finland and Ireland. The selection of a CAE visual system for the prestigious Eurofighter program solidly establishes CAE's Medallion visual system as a premier system for fast jet simulation applications. The Medallion visual system is also being used to upgrade the US Army's Apache combat mission simulators, the German Tornado simulators, and the Canadian CP140 Patrol Aircraft simulator.

Military support services include the provision of contractor logistic support, maintenance services and simulator instruction at over 60 sites worldwide. CAE provides maintenance support for most of the Canadian Forces flight simulators at six bases and all but one of the installed flight simulators of the German Army, Air Force and Navy. In the US, CAE provides a range of services across a wide number of bases, including the instruction of UAV Predator operators. CAE also provides a range of support services to facilities in Australia (including in fiscal 2004 a 10-year, $70 million agreement for flight training support services for all three armed services for the Australian Defense Force), the UK, the Netherlands and Italy, as well as mission software support for Canada's CF-18 fighter aircraft.

The Company believes that its physical presence in countries such as the US, Germany and the UK has enabled it to develop strong relationships and a good reputation with governments and other defense contractors who are important decision makers regarding defense contracts. In fiscal 2004, despite the loss of two important Military projects, Flight School XXI and CF-18 ADCTS, Military was awarded contracts with the US Air Force by the long term agreement with Lockheed Martin on the C-130J aircraft program. In addition, CAE's Military division was selected along with Thales as preferred bidder for NH90 training systems by the NATO Helicopter Management Agency (NAHEMA) and the Nordic Standard Helicopter Program (NSHP). NAHEMA represents the governments of Germany, Italy, France, The Netherlands and Portugal, while NSHP represents Norway, Sweden and Finland. Australia's Defence Material Organization, the Australian Defence Force (ADF), the Canadian Department of National Defence and the US Army Program Executive Office — Simulation, Training and Instrumentation (PEO-STRI) also awarded contracts to CAE. Following the acquisition of BAE SYSTEMS Flight Simulation and Training in Tampa in fiscal 2002 and the subsequent creation of CAE USA Inc., CAE's ability to win contracts with the US military has been significantly enhanced with the awarding of prime contractor status under several omnibus procurement programs.

CAE will focus on growing its business with military customers around the world, and particularly in the US. The Company believes it can capitalize on the experience, expertise and increased visibility with military customers that it has gained from winning and performing significant contracts, such as the UK Royal Air Force Medium Support Helicopter program. CAE will continue its commitment to customer service by focusing on anticipating and meeting the needs of its military clients for highly-customized equipment and training. CAE believes its ability, through CAE USA Inc., to be a prime contractor in the US, in addition to strong supplier relationships with leading US defense contractors, will enable CAE to further penetrate the US military simulation and training market. CAE intends to continue to foster partnerships with key original equipment manufacturers such as AgustaWestland (CAE's partner in the Rotorsim consortium**)** with whom CAE has entered into a joint venture to deliver training equipment and services in support of AgustaWestland aircraft sales worldwide, and Lockheed Martin, with whom CAE is teamed on the C-130J Maintenance and Aircrew Training System program for the USAF. CAE is also leading the Landmark consortium, comprising AgustaWestland and Interserve, which was selected on July 22, 2004 by the UK Ministry of Defence to negotiate a 30-year PFI equipment and training service contract worth approximately $2.4 billion for the Armoured Vehicle Training Service (AVTS) program for the UK Ministry of Defence. CAE will continue to pursue opportunities to provide long-term training services to military organizations, including leveraging the naval training expertise and experience gained in the UK and Canada into other markets.

In July 2004, Eurofighter Simulation Systems (ESS) GmbH awarded a contract to CAE to provide a range of engineering and on-site support services for the visual systems on the Eurofighter Aircrew Synthetic Training Aids (ASTA) program. The contract is valued at approximately $30 million over five years.

In June 2004, the United States Navy has awarded CAE USA a contract initially valued at US$38 million ($52 million) to develop two MH-60S tactical operational flight trainers (TOFTs) and two MH-60S weapons tactics trainers (WTTs). The contract includes options for two additional MH-60S TOFTs and two additional MH-60S WTTs as well as support services that could bring the total value to more than US$75 million ($103 million).

The military simulation and training market is driven by the introduction of new aircraft platforms, upgrades and life extensions to existing aircraft and a shift to greater use of simulation in pilot training programs due to the high degree of realism and the significantly lower cost compared to live training. CAE expects to increase its advantage in lead-time, cost, quality and reputation for performance through continued operational improvements and research and development programs. In particular, CAE launched a research and development program to introduce CAE NeTTS (Networked Tactical Training Solutions), a new PC-based architecture to address the requirement for scalable, re-configurable, cost effective training devices. With a leading-edge technology solution, CAE is well positioned to capitalize on upcoming international military programs in Canada, the US, Europe, the UK, Asia and Australia, as well as teaming and/or collaboration arrangements in other countries.

Marine Controls

CAE is a world leader in the supply of automation and controls systems for the naval and commercial marine markets. CAE's marine control systems monitor and control propulsion, electrical steering, ancillary, auxiliary and damage control systems. CAE's Integrated Platform Management Systems (IPMS) have accumulated over 3.8 million hours of operational experience and have been or are in the process of being installed on more than 140 warships (including submarines) of 18 navies around the world, including those of the US, the UK and Germany. The Company has moved beyond the supply of marine controls into the provision of naval training services through its participation in the 36-year UK Royal Navy Astute Class Submarine Training program. CAE is a leading supplier of maritime mission training devices.

CAE's systems can be provided for new ship classes as well as retrofitted for existing vessels. The Company also provides full scope IPMS trainers and software support facilities. CAE was the first company in the world to provide an integrated On-Board Training System (OBTS) that enables sailors to train whether at sea or in port. CAE's Battle Damage Control Systems (BDCS) provides significant improvement to the traditional plotting of damage assessment information and repair actions with advanced Human-Machine Interface hardware (consoles) at every damage control station. The OBTS and BDCS along with other advanced features of CAE's IPMS greatly improve the operational effectiveness of naval vessels.

The Damatic XD ship automation system sold by CAE Valmarine under license is installed in approximately 450 vessels worldwide. CAE Valmarine supplies many of the world's cruise lines, passenger ferries and cargo vessels. Advanced functionality that CAE pioneered in the naval automation sector, such as its BDCS is now being introduced as Integrated Safety Management System (ISMS) to CAE Valmarine's customers.

Within CAE's Marine Controls business division, the Company also designs and manufactures power plant simulators and provides power plant simulator software upgrades. Power plant training simulators are used by electric utilities to train operators of power plant control rooms. CAE has supplied power plant training simulators to utilities around the world. CAE is the sole supplier of full-scale CANDU simulators and control systems to utilities worldwide. In addition, the Company supplies power plant simulators for pressurized water reactors, boiling water reactors, and fossil and process simulators.

In early 2004, the largest passenger ship ever built, the Queen Mary 2, began its service life. Aboard this ship is the result of one of the largest marine control system implementations ever, CAE's software-based integrated automation system, which on the Queen Mary 2 controls all of the ship's vital machinery, electrical and safety systems.

During the first quarter 2005, CAE was selected to provide the control system for the Ultra Voyager, the world's biggest passenger ship. In addition, CAE Valmarine has received its first-ever order for a dynamic position system, which will be installed in an offshore supply vessel belonging to Norway's Ostensjo Rederi AS.

The naval controls business must grow by expanding the scope of its products and services and by using its technologies and experience in naval control systems to enhance CAE Valmarine's position as a world leader in commercial marine controls. In addition, CAE expects that it will be able to exploit its customer-installed base to enhance CAE's naval simulation and controls equipment and training services.

Continuing its successful participation on multi-year ship programs, Marine was selected in April 2004 for additional delivery of shipboard control systems by the Republic of Korea Navy ("ROKN"). This marked the fifth contract in a series of KDX-II class destroyers, and the tenth selection of CAE's integrated platform management system for the ROKN.

Marine has established long-term relationships with its customers, as well as shipbuilders. This is well illustrated by the contracts obtained in 2004 with the US Navy. Under the latter's DD(X) program, Marine was selected to provide its integrated platform management system through three contracts for the engineering control system, the fire suppression system, and the damage-decision assessment system; valued at $30 to $40 million. Marine was also selected to supply $12 million of electric plant control systems for the largest and most advanced warship in naval history, the Nimitz-class aircraft carrier USS George H.W. Bush, as well as for the US Navy's latest LPD 17 class amphibious ship, along with the USS New York (an LPD 21 class).

Discontinued Operations

In fiscal 2004, CAE completed the divestiture plan started in December 2001 of all its discontinued operations. On April 30, 2003, CAE completed the sale of the operations of CAE Beyss GmbH, another of CAE's Cleaning Technologies businesses, to Bavaria Industriekapital AG. Because the business had not been profitable for some time, CAE received nominal consideration. Subsequent to completing the sale, CAE incurred post disposition costs with respect to the transfer of employees, resulting in a charge recorded in the results of Discontinued Operations of $2.6 million. On May 2, 2003, CAE completed the sale of its remaining wood products business to Carmanah Design & Manufacturing Inc., a TD Capital company, for proceeds of approximately $20 million, plus certain rights to further payment if future earning targets are attained by the wood products business. On July 31, 2003, CAE completed the sale of substantially all the assets of its last remaining Cleaning Technologies business, Alpheus Inc. to Cold Jet Inc. of Cincinnati, Ohio. The total consideration was approximately US$2.1 million. In addition, the company is entitled to receive further consideration of US$1.0 million based on the future performance of the combined businesses over the 53-month period from closing.

5.1(b) Research and Development

CAE differentiates itself by providing superior products and services that rely on the latest, most advanced technology available. As a result, the Company has a long-standing commitment to research and development. Each business segment is encouraged to apply research and development across the whole spectrum of its operations, from product development to production processes and techniques.

An additional part of CAE's research and development strategy is to participate with several universities and government agencies in North America and in Europe in specific research projects. While development is the first priority, applied research is also vitally important to the Company's future. In addition to the basic internal research and development, research and development may also be carried out within customer contracts. This involves the development of technology that is necessary to complete a contract requirement but is also useful and may be reapplied by the Company in a broader sense. Certain CAE initiatives also receive the support of the Canadian government through Technology Partnerships Canada.

Total research and development expenditures include basic research and development costs as well as program related development costs. Basic internal research and development expenditures were in excess of $32 million for fiscal 2004, the product portion of which was largely associated with the development of the CAE NeTTS training system, CAE's Sim XXI™ simulator, CAE's SimFinity™ training system, and CAE's Medallion-S™ visual system. In addition to these development activities, basic internal research and development funds a variety of product enhancement and process improvement initiatives. Basic research and development expenditure is expected to be 10-15% lower in fiscal 2005 and will be primarily focused on extending the capabilities of CAE NeTTS, applying CAE's Sim XXI™ simulator design and manufacturing techniques to additional simulator platforms, extending the capabilities of CAE's SimFinity™ training system, and enhancing CAE's Medallion-S™ and Tropos™ image generators.

5.1(c) Employees and Labor Relations

CAE currently employs approximately 5,500 employees of which approximately 800 are unionized and covered by 14 collective agreements. Five labor contracts were ratified in fiscal 2004 covering our employees at our US military training sites. During fiscal 2005, CAE will enter into negotiations for the renewal of four collective agreements. The collective agreement for 650 employees in Montreal will remain into force until June 2008. There are no indications that negotiations on upcoming contract renewals will result in work stoppages. CAE considers employee relations to be satisfactory.

5.1(d) Manufacturing

CAE's manufacturing facilities are located in Montreal, Canada; Tampa, US; Burgess Hill, UK; and Stolberg, Germany.

The manufacturing process for CAE simulators is complex, involving the coordination of approximately 250,000 parts and millions of lines of software code. The manufacture of a civil simulator includes five major stages: design, manufacture and assembly, testing, pack and ship and final test on-site. This entire process now takes approximately 14 months. Military simulators are much more complex and unique than civil simulators, and therefore take more time to design, manufacture and test.

Manufacturing is organized into 12 manufacturing cells comprised of the following three major disciplines: electronics (printed circuit board assembly), electrical (cables and harnesses, cabinets and chassis, aircraft instruments and avionics), and mechanical (welding, sheet metal and machine shop, precision assembly and hydraulics, structural assembly and final assembly).

Most of the raw materials used in manufacturing (such as sheet metal, wires, cables and electronic integrated circuits) are available off-the-shelf from multiple commercial sources. The unique parts are the aircraft parts. These are usually available from aircraft manufacturers, the resale market, as well as through simulated part manufacturers.

The availability of most parts in a timely manner facilitates a relatively smooth production flow. Aircraft parts, in some instances, may be an exception, especially on new aircraft types or those out of production. The timely delivery of these parts is often the responsibility of CAE's customers. CAE's contracts normally link these aircraft parts delivery dates to the simulator delivery schedules. In cases where such aircraft parts cannot be made available, CAE's customers rely on CAE's ability to make simulated parts.

5.1(e) Competition

The markets in which CAE sells its products are highly competitive. Certain competitors are also the Company's customers and suppliers on specific programs. The extent of competition for any single project generally varies according to the complexity of the product and the dollar volume of the anticipated award. CAE believes that it competes on the basis of:

- the performance and flexibility of its products;
- reputation for prompt and responsive contract performance;
- accumulated technical knowledge, intellectual property and expertise;
- breadth of product line; and
- price.

CAE's future success will depend in large part upon its ability to improve existing product lines and to develop new products and technologies in the same or related fields.

CAE's major competitors in the military simulation and training market include Lockheed Martin Corporation, L-3 Communications Corporation, Boeing, Rockwell Collins NLX Corporation, Indra Systemas, Alenia Marconi Systems, Thales Training Simulation, Flight Safety International, Inc. and Rheinmetall Defence Electronics. Some of these competitors are predominantly local (one country or region) competitors. CAE sometimes partners with these and other competitors to cooperate on program contracts.

CAE's major competitors in the civil simulation equipment market include Thales Training Simulation and Rockwell Collins' NLX Corporation. Evans & Sutherland Computer Corporation also competes for visual systems. The Company's major competitors in civil pilot training include FlightSafety International, Inc., Alteon Training L.L.C. (formerly FlightSafety Boeing Training International), GECAT and PanAm International Flight Academy Inc.

CAE's major competitors in the marine controls market include Lockheed Martin Corporation, Northrop Grumman Corporation (Sperry Marine Systems), Siemens AG, ABB Asea Brown Boveri Ltd., Imtech Marine & Offshore (Netherlands), L-3 Communications Corporation and MTU Elektronik GmbH.

5.1(f) Government Contracts

The majority of CAE's contract revenue in its military simulation and training and marine controls business segments result from contracts with militaries or government bodies performed under predominantly fixed-price contracts with only a small number of cost-plus contracts.

In most instances, under government regulations, certain costs, including certain financial costs, portions of research and development costs, lobbying expenses, certain types of legal expenses and certain marketing expenses related to the preparation of bids and proposals, are not allowed for pricing purposes and calculation of contract reimbursement rates under flexibly-priced contracts. Governments also routinely regulate the methods under which costs are allocated to government contracts. CAE is subject to a variety of audits performed by government agencies. These include pre-award audits that are performed at the submission of a proposal to the government. The purpose of the pre-award audit is to determine the basis of the bid and provide the information required for the relevant government to effectively negotiate the contract. During the performance of a contract the government has the right to request and to examine any labor charges, any material purchase, and any overhead changes to any contract that is active. Upon a contract's completion, the government may perform a post award audit of all aspects of contract performance to insure that the Company has performed in accordance with the terms of the contract.

Government contracts are generally, by their terms, subject to termination by the government either for convenience or default by the contractor. Fixed-price contracts provide for payment upon termination for items delivered to and accepted by the government and, if the termination is for convenience, for payment of fair compensation of work performed plus the costs of settling and paying claims by terminated subcontractors, other settlement expenses and a reasonable profit on the costs incurred. Cost-plus contracts generally provide that, upon termination, the contractor is entitled to reimbursement of its allowable costs and, if the termination is for convenience, a total fee proportionate to the percentage of the work completed under the contract. If a contract termination is for default, however, typically,

- the contractor may be paid an amount agreed upon for completed and partially completed products and services accepted by the government;
- the government may not be liable for the contractor's costs with respect to unacceptable items, and may be entitled to repayment of advance payments and progress payments, if any, related to the termination portion of the contract; and
- the contractor may be liable for excess costs incurred by the government in procuring undelivered items from another source.

In addition to the right of the government to terminate, government contracts are often conditioned upon the continuing availability of appropriations. Consequently, at the outset of a major program, such contracts are usually partially funded and additional monies are normally committed to the contract by the procuring agency only as appropriations are made for future fiscal years. Failure to obtain such appropriations normally results in termination of the contract and compensation to the contractor at less than the full value of the contract.

5.1(g) Intellectual Property

CAE owns certain patents and has filed applications in respect of additional patents. The Company enters into agreements containing non-disclosure and confidentiality clauses with third parties and has similar provisions in place with its employees to protect its proprietary information and trade secrets. CAE also has internal policies concerning both ethics and intellectual property which guide its employees in their dealings with CAE's intellectual property and that of third parties. CAE's Intellectual Property Committee, comprising some of CAE's most senior technology-oriented officers, is mandated to oversee the protection, management and exploitation of the Company's inventions, trade secrets and other intellectual property.

Given the lengthy delay in obtaining patents (during which some technology may evolve into newer generations), the required detailed patent application disclosure which may permit competitors to reverse-engineer an invention, and the cost of maintaining and defending patents, CAE believes that certain intellectual property is adequately protected by either maintaining it as a trade secret or selectively disclosing enough of it to forestall anyone else from subsequently claiming it as their own original innovation.

CAE's agreements with Technology Partnerships Canada restrict CAE's ability to license (other than to customers) or transfer ownership of intellectual property developed with the program's support until all funding has been repaid or Technology Partnerships Canada's consent has been obtained.

5.1(h) Environment

CAE operations include, and past operations and those of some past operators at some of the Company's sites have included, the use, generation, storage, handling and disposal of hazardous materials which are subject to environmental laws and regulations in the various countries in which CAE operates or has operated. CAE believes the exposure to environmental risk to be relatively limited and the Company's operations are in compliance in all material respects with such environmental laws and regulations.

5.2 Risk Factors

CAE's sales cycle is often lengthy and unpredictable, which could result in volatility in its operating results and the price of its common shares.

The sales cycle of CAE's products and services is lengthy and unpredictable, ranging from 6 to 18 months for civil aviation and civil marine applications and from 6 to 24 months or longer for military applications. While customers are evaluating CAE's products and services, the Company may incur expenses and expend management effort. The result of making these expenditures, with no corresponding revenue in any given quarter, could further exacerbate fluctuations of its quarterly operating results and share price volatility.

CAE's success depends on the reliability of its products, the quality of its services and its ability to adapt to changing customer needs in a timely manner.

The civil aviation, military and marine markets in which CAE operates are characterized by changes in customer requirements, new aircraft models and marine vessels and evolving industry standards. CAE's failure to predict accurately the future needs of its customers and prospective customers and to develop product enhancements that address evolving standards and technologies may result in the loss of current customers or negatively affect its revenue and its ability to secure new customers.

A reduction in defense spending could result in a decrease in CAE's revenue.

CAE relies on sales to military customers around the world to generate a significant portion of its revenue. In fiscal 2004, such sales by Military Simulation and Training and the government navy portion of Marine Controls sales accounted for a significant majority of their revenues. CAE acts as prime contractor or major subcontractor for various US, European, Canadian and other foreign government programs. The termination of funding for a government program would result in a loss of anticipated future revenue attributable to that program which could have a negative impact on CAE's operations. A significant reduction in military expenditures by countries with which CAE has contracts could materially adversely affect its sales and earnings.

CAE operates in the civil simulation equipment and training services markets, both of which are heavily dependent on the airline industry.

CAE derives a material portion of its revenue from the supply of equipment and services to the commercial and business airline industry. Reduced demand for air transportation has impacted the operating results of airlines and has lead to a reduction or delay of new aircraft purchases which CAE would expect to result in reduced simulator orders.

Intense competition in CAE's target markets could limit its ability to attract and retain customers.

The markets in which CAE sells its simulation and control equipment and training services are highly competitive. Some of the Company's competitors are larger than CAE and have greater financial, technical, marketing, manufacturing and distribution resources. In addition, some competitors have well-established relationships with aircraft manufacturers, airlines and governments which may give them an advantage over CAE in winning contracts with these organizations. CAE obtains most of its contracts through competitive bidding processes that subject the Company to the risk that it will expend substantial time and effort on proposals for contracts that may not be awarded to the Company. CAE cannot assure that it will continue to win competitively awarded contracts at the same rate as in the past.

CAE's use of fixed-price and long-term supply contracts could subject the Company to losses if there are cost overruns.

CAE provides its products and services primarily through fixed-price contracts that require the absorption of cost overruns, notwithstanding the difficulty of estimating all of the costs incurred in performing these contracts and in projecting the ultimate level of sales that the Company may achieve. In addition, a number of CAE's contracts to supply simulators to commercial airlines are long-term agreements for up to 20 years. These agreements establish the prices for the simulators to be delivered, subject to adjustments for inflation and cost increases. If these adjustments do not fully offset inflation or cost increases, CAE's results of operations could be adversely affected. CAE's business could be harmed if its products do not successfully integrate or operate with other sophisticated and continually evolving software, computing and communications systems. If CAE experiences difficulties or does not meet project milestones in a timely manner, the Company could be obligated to devote more engineering and other resources to a particular project than originally anticipated. While CAE believes it has recorded adequate provisions for losses on fixed-price contracts, obligations under fixed-price and long-term supply contracts could subject the Company to contract losses in excess of provisions.

CAE's government-funded military programs are regulated and subject to audit.

Like most suppliers of products and services to governments, CAE may be audited and reviewed periodically on some projects. Adjustments arising from government audits and reviews may have an adverse effect on results of operations. In addition, some costs may not be reimbursable or allowed in negotiation of fixed-price contracts. Further, as a government contractor, CAE may be subject to an increased risk of legal actions and liabilities which purely private sector companies are not subject to, the results of which could have a material adverse effect on operations. Failure to comply with applicable government regulations and requirements could lead to suspension or being barred from government contracting or subcontracting for a period of time, which would have a negative impact on CAE's operations and could have a negative effect on its reputation and ability to procure other government contracts in the future.

In the future, CAE may not be able to obtain financial support for research and development activities.

Some of CAE's research and development initiatives have been carried out with the financial support of governmental agencies including amounts from the government of Canada through Technology Partnerships Canada. If such financial assistance is not available to the Company in the future, CAE may have to find other financing, which may not be available.

CAE may experience contract cancellations within its existing backlog of orders.

At March 31, 2004, CAE had several hundred active contracts representing a total order backlog of $2.9 billion. If certain of the Company's customers become insolvent or experience other financial difficulties, CAE's revenue would be adversely affected. CAE cannot assure that its existing backlog will result in sales or that any such sales will be profitable.

CAE's ability to protect its intellectual property is limited, and competitors may use CAE's technology which could weaken the Company's competitive position.

CAE relies in part on trade secrets and contractual restrictions, such as confidentiality agreements and licenses, to establish and protect its proprietary rights. Such reliance may be insufficient to prevent misappropriation of CAE's technology or deter others from developing similar technologies. Enforcement of CAE's intellectual property rights or its ability to acquire them may be unavailable or limited in some countries.

Reliance on the intellectual property of others could prevent or delay CAE's performance of contracts or negatively impact margins.

CAE's products contain sophisticated computer systems supplied to the Company by third parties. Such computer systems and software may not always be available to CAE. The production of CAE's simulators is often dependent upon receipt of data, including confidential or proprietary data, concerning the functions, design and performance characteristics of a product or system, the performance of which the Company's simulator is intended to simulate. CAE cannot assure that it will be able to obtain such data on reasonable terms, or at all.

Claims by other companies that CAE's products infringe their proprietary rights could adversely affect the Company's ability to sell its products and increase its costs.

Infringement claims may be brought against CAE or its customers in the future. CAE may not be successful in the defense of such claims and may not be able to develop processes that do not infringe on the rights of third parties or obtain licenses on commercially acceptable terms, if at all. In addition, any litigation related to CAE's intellectual property rights could be lengthy and costly and could adversely affect operations or financial results, whether or not CAE is successful.

CAE is subject to the risks of doing business abroad and currency fluctuations.

CAE has operations in numerous countries and sells its products and services to customers around the world. For the fiscal year ended March 31, 2004, sales to customers outside the US and Canada accounted for approximately 57% of revenue. CAE expects that sales outside the US and Canada will continue to account for a significant portion of revenue for the foreseeable future. As a result, CAE is subject to risks of doing business internationally. The majority of CAE's revenue is not currently denominated in Canadian dollars, and the Company expects that its revenue will continue to be generated in currencies other than the Canadian dollar. A substantial portion of operating expenses are payable in Canadian dollars. Fluctuations in the Canadian dollar exchange rate will impact results of operations and financial condition from period to period. CAE is also subject to the risks of changes to laws and regulations in host countries; the cost and complexity of using foreign representatives and consultants; the imposition of tariffs, embargoes, controls and other restrictions impeding the free flow of goods, information and capital; the difficulties of managing and operating an enterprise and complying with laws in multiple jurisdictions; and general changes in economic and geopolitical conditions. CAE's currency hedging activities may not be successful.

CAE's union agreements are subject to renewal, and the Company may be unable to retain qualified personnel which would harm the ability to carry out its business strategy.

CAE is party to 14 collective bargaining agreements throughout its business units which are subject to expiration at various times in the future. If CAE is unable to renew these agreements, or others as they become subject to renegotiation from time to time, it could result in work stoppages and other labor disturbances which could have a material adverse effect on CAE's business. CAE's success depends to a significant degree upon the continued contributions of its qualified technical personnel and its future ability to attract and retain highly skilled personnel. Any inability to attract and retain qualified personnel in the future may seriously harm CAE's business and results of operations.

CAE's debt agreements may restrict its ability to finance future operations and, if the Company is unable to meet its financial covenants, could cause CAE's debt to be accelerated.

Both the indenture governing CAE's senior notes and the terms of CAE's credit facilities contain restrictive covenants. These restrictions could hurt the Company's ability to finance future operations or capital needs, or to engage in other business activities that may be in CAE's interest. In addition, CAE is also required to comply with specified ratios and tests, including leverage, interest coverage ratios and a consolidated net worth test. A breach of any of these agreements or inability to comply with the required financial ratios or limits could result in a default, which would permit CAE's lenders to declare amounts owed to them due and immediately payable.

CAE's level of debt may adversely affect its financial and operating activity.

CAE incurred indebtedness in connection with fiscal 2002-2003 acquisitions and CAE's capital expenditures greater during the last two year than historical levels as the Company executed its business plan. In the future, CAE may borrow more money, subject to the limitations imposed by senior notes and credit facilities. CAE's indebtedness may affect the way it conducts business.

CAE may be subject to significant environmental liabilities imposed by environmental laws and regulations or contractual indemnities.

CAE's operations include, and its past operations and those of some past operators at some of its sites have included, the use, generation, storage, handling and disposal of hazardous materials. New laws and regulations, stricter enforcement of existing laws and regulations, the discovery of previously unknown contamination, the imposition of new clean-up requirements or claims on indemnities CAE has been given may require the Company to incur substantial costs in the future which could have a material adverse effect on its financial condition and results of operations.

CAE may be subject to liability claims arising from casualty losses.

Due to the nature of CAE's business, the Company may be subject to liability claims arising out of accidents or disasters involving aircraft, marine vessels or power plants for which CAE has provided training equipment or services or control systems used by employees operating or conducting maintenance on such aircraft, marine vessels or power plants, including claims for serious personal injury or death. CAE cannot be certain that its insurance coverage will be sufficient to cover one or more substantial claims.

The products CAE manufactures may be subject to warranty or other claims.

The simulators and control systems CAE manufactures are highly complex and sophisticated and may contain defects that are difficult to detect and correct. The occurrence of errors and failures in CAE's products could result in warranty claims or the loss of customers. Correcting such defects could require significant capital investment. When defective products are integrated in the customers' equipment, CAE may face product liability claims based on damages to such equipment. Any claims, errors or failures could have an adverse effect on operating results and business. CAE cannot be certain that its insurance coverage will be sufficient to cover one or more substantial claims.

CAE is subject to compliance with regulatory rules imposed by aviation authorities that may change without notice, resulting in disruptions to its sales and operations.

CAE is subject to compliance with regulatory rules imposed by aviation authorities that may change without notice, resulting in disruptions to its sales and operations. Any changes imposed by a regulatory agency, including changes imposed by aviation authorities such as the US Federal Aviation Administration to safety standards, could require CAE to make unplanned modifications to its products and services, or may result in delays or cancellations of sales. CAE cannot predict the future impact of changing law or regulation on its operations and any changes could have a material adverse effect on its results of operations or financial condition.

Sales or licenses of certain CAE products require regulatory approvals.

The sale or license of virtually all of CAE's products is subject to regulatory controls, including the prohibition of sales to certain countries, or of certain technology such as military-related simulators and nuclear power plant system simulators, without an export license or other approvals. These regulations change with some frequency. CAE cannot assure that it will be permitted to sell or license certain products to customers and the Company may lose potential revenue as a result of the application of such regulations. Failure to comply with any of these regulations in the countries in which CAE operates could subject the Company to fines and other material sanctions.

CAE's ability to retain and attract key personnel.

CAE's continued success will depend in part on the ability to retain and attract key personnel with the relevant skills, expertise and experience. The Company applies a compensation policy designed to mitigate this risk.

ITEM 6 — DIVIDENDS

Quarterly cash dividends of $0.025 per common share were declared during fiscal 2001 and for the last three-quarters of fiscal 2000.

On June 20, 2001, the Board of Directors declared a 100% stock dividend in respect of CAE's common shares, effectively achieving a two-for-one split of outstanding common shares. CAE's common shares commenced trading on a split basis on July 5, 2001 on The Toronto Stock Exchange. CAE ascribed essentially no monetary value to the stock dividend.

Commencing with the dividend payable on September 28, 2001, CAE raised the quarterly dividend to $0.03 per common share. The Company currently intends to maintain the quarterly dividend of $0.03 per common share. However, any decision to declare and pay dividends in the future will be made at the discretion of the Board of Directors, after taking into account the financial results, capital requirements and other factors the directors may deem relevant.

Until February 29, 2004, the Company's Dividend Reinvestment Plan (DRIP) provided that eligible shareholders (which covered all shareholders living wherever the shares were distributed) could elect to receive common stock dividends in lieu of cash dividends. As of March 1, 2004, eligibility has been limited to Canadian resident shareholders. During fiscal 2002, 2003 and 2004, CAE issued 17,605; 54,622 and 106,002 common shares, respectively, as share dividends.

ITEM 7 — DESCRIPTION OF CAPITAL STRUCTURE

Our authorized capital consists of an unlimited number of common shares without par value and an unlimited number of preferred shares without par value, issuable in series.

Each common share entitles the holder thereof to dividends if, as and when declared by our directors, to one vote at all meetings of holders of common shares and to participate, pro rata, with the holders of common shares, in any distribution of our assets upon liquidation, dissolution or winding-up, subject to the prior rights of holders of shares ranking in priority to common shares.

On September 30, 2003, the Company issued 26,600,000 common shares at a price of $6.58 per share, for a cash proceeds of $175 million.

As at the close of business on March 31, 2004, 246,649,180 common shares were issued and outstanding. There are no preferred shares issued and outstanding.

ITEM 8 — MARKET FOR SECURITIES

The outstanding common shares of the Company are listed and posted for trading on The Toronto Stock Exchange under the symbol "CAE" and on the New York Stock Exchange under the symbol "CGT".

8.1 Trading Price and Volume

CAE Inc.
TSE Share Price Information
FY 2004

Month	Max	Min	Total Volume
April-03	3.79	3.13	27,062,400
May-03	4.62	3.60	27,344,500
June-03	5.73	4.79	21,616,200
July-03	6.33	5.87	27,356,800
August-03	6.15	5.29	15,768,500
September-03	6.77	5.07	35,664,500
October-03	5.69	5.27	17,497,600
November-03	6.01	5.27	36,954,700
December-03	5.94	5.37	19,085,400
January-04	6.74	5.60	29,867,500
February-04	6.74	5.98	30,810,800
March-04	6.54	5.57	35,900,000

CAE Inc.
NYSE Share Price Information
FY 2004

Month	Max	Min	Total Volume
April-03	2.52	2.16	720,600
May-03	3.40	2.52	779,400
June-03	4.27	3.55	594,300
July-03	4.65	4.25	408,500
August-03	4.39	3.79	286,400
September-03	4.95	3.74	503,100
October-03	4.29	4.00	482,400
November-03	4.57	4.07	1,958,700
December-03	4.56	4.05	362,200
January-04	4.80	4.35	1,302,700
February-04	5.10	4.45	505,700
March-04	4.85	4.18	809,100

ITEM 9 — DIRECTORS AND OFFICERS

The directors of the Company are elected at each annual meeting of shareholders and hold office until the next annual meeting of shareholders or until their successors are elected or appointed. The names and municipalities of residence of the directors and officers of the Company, the positions and offices held by them in the Company, and their respective principal occupations for the last five years are set forth below. In addition to fulfilling all statutory requirements, the Board of Directors oversees and reviews: (i) the strategic and operating plans and financial budgets and the performance against these objectives; (ii) the principal risks and the adequacy of the systems and procedures to manage these risks; (iii) the compensation and benefit policies; (iv) management development and succession planning; (v) business development initiatives; (vi) the communications policies and activities, including shareholder communications; (vii) the integrity of internal controls and management information systems; (viii) the monitoring of the corporate governance system; and (ix) the performance of the President and Chief Executive Officer.

The Committees of the Board of Directors are the Audit Committee, the Governance Committee, the Compensation Committee and the Executive Committee.

9.1 Name and Occupation

DIRECTORS

Name and Municipality of Residence and Year first became a director	Principal Occupation
ROBERT E. BROWN Westmount, Quebec (2004)	Chairman of the Board of Air Canada. Prior to joining Air Canada in March 2003, Mr. Brown was president and Chief Executive Officer of Bombardier Inc. from February 1999 to December 2002. Mr. Brown will succeed Derek H. Burney as President and Chief Executive Officer of the Corporation on August 12th, 2004. Mr. Brown is a director of Nortel Networks Corporation, Vanguard Response Systems and Lyrtech Inc.
DEREK H. BURNEY, O.C. Toronto, Ontario (1999)	President and Chief Executive Officer of the Corporation and is a member of the Executive and Succession Committees. Mr. Burney is also a director of Shell Canada Limited and Quebecor World Inc.
JOHN A. (IAN) CRAIG Ottawa, Ontario (2000)	Business consultant. Mr. Craig is also a director of Bell Canada International Inc., Arris International, XPU Capital and the Ottawa Heart Institute. Mr. Craig is a member of the Audit Committee.
RICHARD J. CURRIE, C.M. Toronto, Ontario (2001)	Non-executive Chairman of Bell Canada Enterprises Inc. He is a director of Staples, Inc. and Petro-Canada and Chancellor of the University of New Brunswick. Mr. Currie is a member of the Audit Committee.
R. FRASER ELLIOTT, C.M., Q.C. Toronto, Ontario (1951)	Senior partner in the legal firm of Stikeman Elliott LLP (Toronto). Mr. Elliott is also a director of the Toronto General & Western Hospital Foundation. Mr. Elliott is a member of the Executive and Succession Committee.

H. GARFIELD EMERSON, Q.C. Toronto, Ontario (1992)	National Chairman and a senior partner of the national law firm of Fasken Martineau DuMoulin LLP. Mr. Emerson is also the Chairman of the Board of Rogers Communications Inc., and Vice-Chairman of the Board of Rogers Wireless Communications Inc. He is also a director of Canada Deposit Insurance Corporation, Rogers Cable Inc., Rogers Media Inc., Wittington Investments Limited and Sunnybrook & Women's College Health Sciences Centre. Mr. Emerson is a member of the Governance Committee.
ANTHONY S. FELL, O.C. Toronto, Ontario (2000)	Chairman of RBC Dominion Securities Inc. Mr. Fell is also a Chairman of Munich Reinsurance Company of Canada, a director of BCE Inc and Loblaw Companies Limited, and Chairman of the Board of Trustees of University Health Network. Mr. Fell is the Chairman of the Governance Committee and a member of the Succession Committee.
THE HONOURABLE JAMES A. GRANT, P.C., C.M., Q.C. Montreal, Quebec (1991)	Partner in the legal firm of Stikeman Elliott LLP (Montreal). Mr. Grant is a director of Canadian Imperial Bank of Commerce, Shire Pharmaceuticals Group plc and various charitable and social organizations. Mr. Grant is a member of the Compensation, Succession and Executive Committees.
JAMES F. HANKINSON Toronto, Ontario (1995)	Business consultant. He is also a director of Maple Leaf Foods Inc., Ontario Power Generation Inc. and Chair of the Board of Trustees of ROW Entertainment Income Fund. Mr. Hankinson is the Chairman of the Audit Committee and a member of the Governance and Succession Committees.
E. RANDOLPH (RANDY) JAYNE II Tysons Corner, Virginia (2001)	Senior Partner in Heidrick & Struggles International, Inc., an executive search firm (1996-present), and is currently the Office Managing Partner of that firm's Tysons Corner, VA office. Mr. Jayne is a member of the Compensation Committee.

JAMES W. MCCUTCHEON, Q.C. Toronto, Ontario (1979)	Counsel to the law firm of McCarthy Tétrault LLP. Mr. McCutcheon is a director of Dominion of Canada General Insurance Company, Empire Life Insurance Company (Chairman 1991-1997), Guardian Capital Group Limited and Noranda Inc. Mr. McCutcheon is a member of the Audit Committee.
LAWRENCE N. STEVENSON Philadelphia, Pennsylvania (1998)	Chief Executive Officer of Pep Boys, a NYSE-listed US automotive services company. Mr. Stevenson is also a director of SNC-Lavalin Group Inc. Mr. Stevenson is Chairman of the Compensation Committee and a member of the Succession Committee.
LYNTON R. WILSON, O.C. Oakville, Ontario (1997)	Chairman of the Board of the Corporation, Chairman of the Executive and Succession Committees and is a member of the Compensation and the Governance Committees. Mr. Wilson is the Chairman of Nortel Networks Corporation and a director of DaimlerChrysler AG and DaimlerChrysler Canada Inc.

OFFICERS WHO ARE NOT DIRECTORS

Name and Municipality of Residence	Office held with CAE and Principal Occupation [1]
DONALD W. CAMPBELL Ottawa, Ontario	Group President, Military Simulation and Training; formerly Executive Vice President, Military Simulation and Training 2000 to 2002; Deputy Minister of Foreign Affairs and Prime Minister's Personal Representative for Economic Summit, 1997 to 2000; Ambassador to Japan, 1993-1997.
JEFFREY G. ROBERTS Montreal, Quebec	Group President, Civil Simulation and Training of CAE Inc. appointed in February 2004 prior to this nomination he had joined CAE team in 2001, formerly Chief Executive Officer SimuFlite Training International Inc 1999 to 2001.
PAUL G. RENAUD Mississauga, Ontario	Executive Vice President, Chief Financial Officer and Secretary; formerly Vice President Finance, Chief Financial Officer and Secretary, 1997 to 2000.
RASHID A. KHAN St-Lazare, Quebec	Executive Vice President, Marine Controls; formerly Vice President and General Manager, Marine Systems, CAE Electronics Ltd., 1998 to 2000; Director Marine Control Systems and Power Plant Simulation, CAE Electronics Ltd., 1997 to 1998.
R. HANI MACRAMALLAH Montreal, Quebec	Executive Vice-President, Operations; formerly Vice-President, Operations, CAE Electronics Ltd. 1997 to 2000.
HARTLAND J.A. PATERSON Westmount, Quebec	Vice President, Legal and General Counsel, 2001 to present; formerly Vice President, Legal and Regulatory of Cable & Wireless PLC (Japan), 1999 to 2001; Director Legal Affairs of Cable & Wireless PLC (Caribbean) from 1997 to 1999.

ALINE BELANGER Montreal, Quebec	Vice President, Assistant Secretary and Corporate Controller, 2002 to present; formerly Director of Finance for Civil Simulation and Training, 2000 to 2002; Director of Financial Reporting and Analysis for Bell Canada International, 1999 to 2000; Principal Consultant for PricewaterhouseCoopers, 1999.
GUY BLANCHETTE St-Bruno, Quebec	Vice President, and Treasurer, 2004 to present; formerly Chief Financial Officer Alstom Canada Inc.; Vice President Finance and Strategic Planning with SNC Industrial Technologies Inc. before he became Vice President, Treasurer and General Manager with SNC-Equity.

1 Where the date 1999 appears, it signifies the beginning of the last five years and not necessarily the date upon which the individual commenced the relevant position or occupation.

The directors and senior officers of the Company as a group as at the date hereof beneficially own, directly or indirectly, or exercise control or direction over common shares, which represent 3.7% of the Company's outstanding common shares.

9.2 Cease, Trade Orders, Bankruptcies, Penalties or Sanctions

None of the proposed directors of CAE is, or within ten years prior hereto has been, subject to a cease trade or similar order except that Messrs. Wilson and Brown are subject to cease trade orders of the Ontario Securities Commission and two other Canadian securities regulators prohibiting them, as directors of Nortel Networks Corporation and Nortel Networks Limited (collectively, "Nortel"), from trading in securities of Nortel. The orders will be lifted after the receipt by the regulators of filings Nortel is required to make.

9.3 Conflicts of Interest

The law firm Stikeman Elliott LLP, of which Messrs. Grant and Elliott are partners, provided legal services to the Company in fiscal 2004 and continues to provide such services to the Company. The law firm's fees to the Company are less than 2% of the law firm's annual consolidated gross revenues.

ITEM 10 — TRANSFER AGENTS AND REGISTRARS

The Corporation only has common shares issued. The Corporation's transfer agent is Computershare Trust Company of Canada located at 100 University Avenue, Toronto, Ontario, M5J 2Y1.

ITEM 11 — ADDITIONAL INFORMATION

Additional information, including directors' and officers' remuneration and indebtedness, principal holders of the Company's securities, options to purchase securities and interests of insiders in material transactions, where applicable, is contained in the Proxy Information Circular dated June 23, 2004, in connection with the Company's Annual and Special Meeting of Shareholders held on August 11, 2004. Additional financial information, including comparative consolidated audited financial statements and MD&A, are provided in the Company's Annual Report to the shareholders for the financial year ended March 31, 2004. A copy of such documents may be obtained from the Director, Corporate Communications and Investor Relations or the Secretary of the Company upon request, or available online at www.sedar.com, as well as the Company's website at www.cae.com.

In addition, the Company will provide to any person or company, upon request to the Director, Corporate Communications and Investor Relations or the Secretary of the Company, the documents specified below:

(a) When the securities of the Company are in the course of a distribution under a preliminary short form prospectus or a short form prospectus:

(i) one copy of the annual information form of the Company together with one copy of any document, or the pertinent pages of any document, incorporated by reference in such annual information form;

(ii) one copy of the comparative financial statements of the Company for its most recently completed financial year together with the accompanying report of the auditors and one copy of the most recent interim financial statements of the Company for any period after the end of its most recently completed financial year;

(iii) one copy of the information circular in respect of its most recent annual meeting of shareholders that involved the election of directors; and

(iv) one copy of any other documents which are incorporated by reference into the preliminary short form prospectus or the short form prospectus and are not required to be provided under (i) to (iii) above; or

(b) At any other time, one copy of any other document referred to in clauses (i), (ii) and (iii) of paragraph (a) above, provided that the Company may require the payment of a reasonable charge if the request is made by a person or company who is not a security holder of the Company.

SCHEDULE "A" — SUBSIDIARIES

Set forth below are the names of all the direct and indirect subsidiaries of the Company. All companies are wholly owned except as noted.

Name of Subsidiary	Jurisdiction of Incorporation
Canada	
3985954 Canada Inc.	Canada
4025164 Canada Inc.	Canada
CAE International Holdings Limited	Canada
CAE Railway Ltd.	Canada
CAE Machinery Ltd.	British Columbia
United States	
CAE (US) Inc.	Delaware
CAE (US) LLC	Delaware
CAE USA Inc.	Delaware
Civil Aviation Training Solutions Inc.	Florida
CAE Center Dallas, Inc.	Texas
CAE SimuFlite Inc.	Texas
Europe	
CAE Center Brussels N.V	Belgium
Simubel N.V. (a CAE Aviation Training Company)	Belgium
CAE Beyss Grundstücksgesellschaft GmbH	Germany
CAE Elektronik GmbH	Germany
CAE Verwaltungsgesellschaft mbH	Germany
CityLine Canadair Simulator und Training GmbH (15%)	Germany
SAGO Grünstucks-Verwaltungsgesellschaft mbH (51%)	Germany
SAGO Grünstucks-Verwaltungsgesellschaft mbH & Co. KG (95%)	Germany
ZFB Zentrum für Flugsimulation Berlin GmbH (17%)	Germany
CAE International Capital Management Hungary LLC	Hungary
CAE Italy S.r.l.	Italy
CAE Euroco S.à.r.l.	Luxembourg
CAE Investments S.à r.l.	Luxembourg
B.V. Nationale Luchtvaartschool	Netherlands
CAE Aviation Training B.V.	Netherlands
CAE Center Amsterdam B.V.	Netherlands
CAE Center Maastricht B.V.	Netherlands
CAE Flight Crew Training B.V.	Netherlands
CAE Holdings BV	Netherlands
CAE Investments BV	Netherlands
CAE Training Aircraft B.V.	Netherlands

CAE Training B.V.	Netherlands
NLS Amsterdam B.V.	Netherlands
CAE Holding Norway AS	Norway
CAE Navigation AS	Norway
CAE Valmarine AS	Norway
Academia Aeronautica De Evora S.A.(56%)	Portugal
CAE Servicios Globales de Instruccion de Vuelo S.L.	Spain
Servicios de Instrucción de Vuelo S.L. (80%)	Spain
CAE Holdings Ltd.	United Kingdom
Invertron Simulators plc	United Kingdom
CAE (UK) plc	United Kingdom
CAE Aircrew Training Services plc (78%)	United Kingdom
CVS Leasing Limited (13.39%)	United Kingdom
Fast Holdings Limited (47.5%)	United Kingdom
Fast Training Services Limited	United Kingdom
Landmark Operations Limited	United Kingdom
Landmark Training Limited	United Kingdom

Other

CAE Australia Pty Ltd.	Australia
CAE South America Flight Training do Brasil Ltda	Brazil
Qindao Fei Sheng International Aviation Training Technology Development Co. Ltd.(33%)	China
Zhuhai Xiang Yi Aviation Technology Company Limited (49%)	China
CAE Dubai LLC (49%)	Dubai
CAE Electronics Private Ltd.	India
CAE Electronics SDN BHD	Malaysia
CAE Labuan Inc.	Malaysia
CAE Aviation Training International Ltd.	Mauritius
Flight Training Device (Mauritius) Limited	Mauritius

DISCONTINUED OR INACTIVE

Name of Subsidiary	Jurisdiction of Incorporation
Canada	
CAE Pederson Ltd. (49%)	British Columbia
United States	
CAE CT Inc.	California
CAE Railway Inc.	Delaware
Europe	
CAE Screenplates SA	France
CAE Beteiligungsgesellschaft mbH	Germany
CAE Grundstücksgesellschaft mbH	Germany
CAE Screenplates AB	Sweden
Other	
CAE Simco (Barbados) Ltd.	Barbados
CAE MRAD Pty Ltd.	Australia
ISDAT Simulation SDN BHD (20%)	Malaysia

QuickLinks

Exhibit 1

SCHEDULE "A" — SUBSIDIARIES

QuickLinks -- Click here to rapidly navigate through this document

Exhibit 2

MANAGEMENT AND AUDITORS' REPORTS

MANAGEMENT'S STATEMENT OF RESPONSIBILITY

The consolidated financial statements contained in this Annual Report are the responsibility of management, and have been prepared in accordance with Canadian generally accepted accounting principles and include when necessary some estimates based on management best judgment. Financial information presented elsewhere in the Annual Report is under management responsibilities and consistent with that contained in the accompanying financial statements.

CAE's policy is to maintain internal accounting and administrative systems, combined with disclosure control of high quality consistent with reasonable cost. Such systems are designed to provide reasonable assurance as to the reliability of financial information and the safeguarding of assets.

The Board of Directors is responsible for ensuring that Management fulfils its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the consolidated financial statements through its Audit Committee, consisting solely of outside directors, which reviews the consolidated financial statements and reports thereon to the Board. The Committee meets periodically with the external auditors, internal auditors and management to review their respective activities and to satisfy itself that each party is properly discharging its responsibilities. Both external auditors and internal auditors have free access to the Committee, with or without management, to discuss the scope of their audits, the adequacy of the system of internal controls and financial reporting.

The financial statements have been reviewed by the Audit Committee and, together with the other required information in the Annual Report, approved by the Board of Directors. In addition, the consolidated financial statements have been audited by PricewaterhouseCoopers LLP, whose report is provided below.



D.H. BURNEY
President and Chief Executive Officer



P.G. RENAUD
Executive Vice President,
Chief Financial Officer and Secretary

Montreal, Canada
May 11, 2004

AUDITORS' REPORT

To the Shareholders of CAE Inc.

We have audited the Consolidated Balance Sheets of CAE Inc. as at March 31, 2004 and 2003, and the consolidated statements of earnings, retained earnings and cash flows for each of the years in the three-year period ended March 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 2004 and 2003, and the results of its operations and cash flows for each of the years in the three-year period ended March 31, 2004 in accordance with Canadian generally accepted accounting principles.



Chartered Accountants
Montreal, Canada
May 11, 2004

Comments by Auditors for US Readers on Canada-US Reporting Difference

In the United States, reporting standards for auditors require the addition of an explanatory paragraph (following the opinion paragraph) when there is a change in accounting principles that has a material effect on the comparability of the company's financial statements, such as the changes described in note 1 to the consolidated financial statements. Our report to the shareholders dated May 11, 2004 is expressed in accordance with Canadian reporting standards which do not require a reference to such a change in accounting principles in the auditors' report when the change is properly accounted for and adequately disclosed in the financial statements.



Chartered Accountants
Montreal, Canada
May 11, 2004

CONSOLIDATED BALANCE SHEETS

as at March 31 (amounts in millions of Canadian dollars)	2004	2003
Assets		
Current assets		
Cash and cash equivalents	**$ 61.9**	$ 17.1
Short-term investments	**—**	2.6
Accounts receivable (note 4)	**390.9**	373.1
Inventories (note 5)	**154.8**	136.3
Prepaid expenses	**20.7**	14.0
Income taxes recoverable	**52.0**	25.7
Future income taxes (note 14)	**1.8**	3.5
	682.1	572.3
Restricted cash	**7.0**	14.4
Assets of discontinued operations (note 3)	**—**	50.0
Property, plant and equipment, net (note 6)	**843.0**	930.4
Future income taxes (note 14)	**93.8**	85.7
Intangible assets (note 7)	**155.2**	171.7
Goodwill (note 8)	**343.8**	366.8
Other assets (note 9)	**168.4**	165.2
	$ 2,293.3	$ 2,356.5
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	**$ 350.0**	$ 413.3
Deposits on contracts	**91.1**	101.2
Long-term debt due within one year (note 10)	**13.5**	13.4
Future income taxes (note 14)	**51.1**	42.4
	505.7	570.3
Liabilities of discontinued operations (note 3)	**—**	17.9
Long-term debt (note 10)	**623.4**	798.0
Deferred gains and other long-term liabilities (note 15)	**155.6**	139.6
Future income taxes (note 14)	**89.8**	80.5
	1,374.5	1,606.3
Shareholders' equity		
Capital stock (note 11)	**367.5**	190.5
Contributed surplus (note 12)	**1.3**	—
Retained earnings	**562.1**	531.2
Currency translation adjustment (note 21)	**(12.1)**	28.5
	918.8	750.2
	$ 2,293.3	$ 2,356.5

Commitments and contingencies (notes 17 and 19)

Approved by the Board:



D.H BURNEY
Director



L.R. WILSON
Director

The accompanying notes form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF EARNINGS

years ended March 31 (amounts in millions of Canadian dollars, except per share amounts)	2004	2003	2002
Revenue			
Civil Simulation and Training	**$ 461.8**	$ 517.2	$ 545.2
Military Simulation and Training	**472.8**	445.7	461.8
Marine Controls	**158.6**	167.6	119.5
	$ 1,093.2	$ 1,130.5	$ 1,126.5
Earnings before interest, income taxes and discontinued operations			
Civil Simulation and Training	**$ 39.4**	$ 116.2	$ 158.8
Military Simulation and Training	**52.6**	73.6	65.6
Marine Controls	**29.6**	31.8	23.6
Restructuring Costs (note 23)	**(10.0)**	—	(7.0)
Earnings before interest, income taxes and discontinued operations	**111.6**	221.6	241.0
Interest on debt (note 10 (ix))	**30.0**	34.1	26.1
Other interest income, net	**(6.1)**	(3.7)	(3.4)
Earnings before income taxes and discontinued operations	**87.7**	191.2	218.3
Income taxes (note 14)	**20.6**	60.2	69.9
Earnings from continuing operations	**$ 67.1**	$ 131.0	$ 148.4
Results of discontinued operations (note 3)	**(3.1)**	(13.8)	1.1
Net earnings	**$ 64.0**	$ 117.2	$ 149.5
Basic and diluted earnings per share from continuing operations	**$ 0.29**	$ 0.60	$ 0.68
Basic and diluted net earnings per share	**$ 0.27**	$ 0.53	$ 0.69
Weighted average number of common shares outstanding	**233.2**	219.4	217.6

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

years ended March 31 (amounts in millions of Canadian dollars)	2004	2003	2002
Retained earnings at beginning of year	**$ 531.2**	$ 440.4	$ 315.9
Share issue costs (net of taxes of $2.4 million)	**(5.1)**	—	—
Net earnings	**64.0**	117.2	149.5
Dividends	**(28.0)**	(26.4)	(25.0)
Retained earnings at end of year	**$ 562.1**	$ 531.2	$ 440.4

The accompanying notes form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOW

years ended March 31 (amounts in millions of Canadian dollars)	2004	2003	2002
Operating activities			
Earnings from continuing operations	**$ 67.1**	$ 131.0	$ 148.4
Adjustments to reconcile earnings to cash flows from operating activities:			
Amortization	**75.4**	70.6	43.1
Future income taxes	**2.1**	18.8	7.1
Investment tax credits	**(22.8)**	(18.6)	(19.0)
Stock-based compensation	**1.3**	—	—
Other	**(6.3)**	(18.1)	1.1
Increase in non-cash working capital (note 16)	**(107.2)**	(41.3)	(7.6)
Net cash provided by continuing operating activities	**9.6**	142.4	173.1
Net cash (used in) provided by discontinued operating activities	**(3.9)**	12.5	(15.9)
Net cash provided by operating activities	**5.7**	154.9	157.2
Investing activities			
Purchase of businesses (note 2)	**—**	—	(757.6)
Proceeds from disposal of discontinued operations (note 3)	**22.3**	25.0	187.1
Short-term investments, net	**2.6**	18.8	101.5
Capital expenditures	**(94.5)**	(238.9)	(249.6)
Proceeds from sale and leaseback of assets	**122.5**	127.0	42.6
Deferred development costs	**(12.7)**	(13.3)	(31.1)
Deferred pre-operating costs	**(10.4)**	(10.7)	(15.1)
Other assets	**(5.3)**	(27.5)	(33.0)
Net cash provided by (used in) continuing investing activities	**24.5**	(119.6)	(755.2)
Net cash used in discontinued investing activities	**—**	(14.8)	(4.7)
Net cash provided by (used in) investing activities	**24.5**	(134.4)	(759.9)
Financing activities			
Proceeds from long-term debt	**525.3**	270.0	755.8
Repayments of long-term debt	**(650.4)**	(326.3)	(195.6)
Dividends paid	**(27.4)**	(26.2)	(24.8)
Capital stock issuances (note 11)	**176.4**	3.5	6.1
Share issue costs	**(7.5)**	—	—
Other	**1.4**	(14.1)	(2.3)
Net cash provided by (used in) continuing financing activities	**17.8**	(93.1)	539.2
Net cash used in discontinued financing activities	**—**	(1.3)	(3.9)
Net cash provided by (used in) financing activities	**17.8**	(94.4)	535.3
Effect of foreign exchange rate changes on cash and cash equivalents	**(3.2)**	2.2	(0.6)
Net increase (decrease) in cash and cash equivalents	**44.8**	(71.7)	(68.0)
Cash and cash equivalents at beginning of year	**17.1**	88.8	156.8
Cash and cash equivalents at end of year	**$ 61.9**	$ 17.1	$ 88.8

Supplementary cash flow information (note 16)

The accompanying notes form an integral part of these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

years ended March 31, 2004, 2003 and 2002 (amounts in millions of Canadian dollars)

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of CAE Inc. and its subsidiaries ("CAE" or "the Company") conform with Canadian generally accepted accounting principles (Canadian GAAP). These accounting principles are different in some respects from United States generally accepted accounting principles (U.S. GAAP). The significant differences are described in note 24.

NATURE OF OPERATIONS

CAE designs and provides simulation equipment and services and develops integrated training solutions for the military, commercial airlines, business aircraft operators, aircraft manufacturers and marine vessel operators.

CAE's flight simulators replicate aircraft performance in normal and abnormal operations and a comprehensive set of environmental conditions, utilizing visual systems with an extensive database of airports, other landing areas and flying environments and motion and sound cues to create a fully immersive training environment. The Company offers a full range of flight training devices based on the same software used in its simulators. CAE operates a global network of training centres in locations around the world.

The Company also provides simulators and training services for sea- and land-based activities and supplies marine automation systems for military and civil applications. CAE's marine control systems monitor and control propulsion, electrical steering, ancillary, auxiliary and damage control systems.

CONSOLIDATION

The consolidated financial statements include the accounts of CAE Inc. and all subsidiaries. All inter-corporate accounts and transactions have been eliminated. Acquisitions are accounted for using the purchase method and, accordingly, the results of operations of subsidiaries are included from the respective dates of acquisition. Portfolio investments are accounted for using the cost method.

REVENUE RECOGNITION

Revenue from long-term contracts for building simulators and controls systems is recognized using the percentage-of-completion method where revenue, earnings and unbilled accounts receivable are recorded as related costs are incurred, on the basis of the percentage of actual costs incurred to date on a contract, relative to the estimated total costs to complete that contract. Revisions in cost and earnings estimates during the term of the contract are reflected in the period in which the need for revision becomes known. Losses, if any, are recognized fully when first anticipated. Generally, the terms of long-term contracts provide for progress billings based on completion of certain phases of work. Warranty provisions are recorded at the time revenue is recognized, based on past experience. No right of return or complimentary upgrades are provided to customers. Post-delivery customer support is billed separately and revenue is recorded ratably over the support period.

Training service revenues are recognized in the period such services are provided. All other revenue is recorded and related costs transferred to cost of sales at the time the product is delivered and the benefits and the risks of ownership associated with the product are transferred to the customer.

CASH AND CASH EQUIVALENTS

Cash consists of cash and cash equivalents, which are short-term, highly liquid investments with original terms to maturity of 90 days or less.

SHORT-TERM INVESTMENTS

Short-term investments include money market instruments and commercial paper carried at the lower of cost or market value.

INVENTORIES

Raw materials are valued at the lower of cost and replacement cost. Work in process is stated at the lower of average cost and net realizable value. The cost of work in process includes material, labour and an allocation of manufacturing overhead.

RESTRICTED CASH

Under the terms of subsidiaries external bank financing and some government-related sales contracts, the Company is required to hold a defined amount of cash as collateral.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at amortized cost. The declining balance and straight-line methods are used in computing amortization over the estimated useful lives of the assets. Useful lives are estimated as follows:

Building and improvements	20 to 40 years
Machinery and equipment	3 to 10 years
Simulators	12 to 25 years

In fiscal year 2003, the Company changed the amortization period for Civil simulation equipment from 20 years to 25 years, to reflect the approximated useful life of the simulators. That change reduced the amortization expense by $3.7 million in fiscal 2003 as compared to fiscal 2002.

LEASES

Leases entered into by the Company in which substantially all the benefits and risks of ownership are transferred to the Company are recorded as capital leases and classified as property, plant and equipment and long-term borrowings. All other leases are classified as operating leases under which leasing costs are expensed in the period in which they are incurred. Gains on the sale and leaseback of simulators are deferred and the gains in excess of the residual value guarantees are amortized over the term of the lease.

The residual value guarantees are to be recognized in the Company's earnings upon expiry of the related sale and leaseback agreement.

BUSINESS COMBINATIONS, GOODWILL AND INTANGIBLE ASSETS

The Company accounts for its business acquisitions using the purchase method. Goodwill represents the cost of investments in subsidiaries in excess of the fair value of the net identifiable assets acquired. Goodwill acquired in a business combination is accounted for under CICA Handbook Section 3062, *Goodwill and Other Intangible Assets*. This section requires that goodwill not be amortized. The fair value is to be assessed at least annually and, if necessary, is written down to such fair value for any impairment.

Intangible assets are recorded at their fair value at the date of acquisition of the related operating companies. Amortization is provided for all intangible assets on a straight-line basis over their estimated useful lives as follows:

	Amortization Period	Weighted Average Amortization Period
Trade names	20 to 25 years	21
Backlog and contractual agreements	1 to 20 years	10
Customer relationships	10 to 25 years	24
Other	12 to 20 years	16

INTEREST CAPITALIZATION

Interest costs relating to the construction of simulators and buildings for training centres are capitalized as part of the cost of property, plant and equipment. Capitalization of interest ceases when the simulator is completed and ready for productive use.

FOREIGN CURRENCY TRANSLATION

The functional currency of the Company and each of its subsidiaries is the local currency. Monetary assets and liabilities denominated in currencies other than the functional currency are translated at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities denominated in currencies other than the functional currency are translated into the functional currency using the exchange rate prevailing at the dates of the respective transactions. Revenue and expense items are translated at average rates of exchange for the year. Translation gains or losses are included in the determination of earnings, except for gains or losses arising on translation of accounts of foreign subsidiaries considered self-sustaining, exchange gains and losses on inter-company account balances that form part of the net investment in foreign operations and gains or losses arising from the translation of foreign currency debt that has been designated as a hedge of the net investment in subsidiaries, which are reflected as a separate component of shareholders' equity.

Earnings from continuing operations include a net foreign exchange gain of $10.6 million in 2004 or 5 cents per share (2003 — net foreign exchange gain of $6.1 million or 3 cents per share, 2002 — net foreign exchange loss of $1.2 million or 1 cent per share).

RESEARCH AND DEVELOPMENT COSTS

Research costs are charged to earnings in the periods in which they are incurred. Development costs are also charged to earnings in the period incurred unless they meet the criteria for deferral. Government assistance arising from research and development costs is deducted from the related costs. Amortization of development costs deferred to future periods commences with the commercial production of the product and is charged to earnings based on anticipated sales of the product, over a period not exceeding five years.

PRE-OPERATING COSTS

The Company defers expenditures incurred during the pre-operating period for all new training centres. Expenditures directly related to placing a new training centre into commercial service are incremental in nature and are considered by management to be recoverable from the future operations of the new training centre. Capitalization ceases at the opening of the training centre. Amortization of the deferred costs is taken over five years in respect to civil training operations and marine operations and over 20 years for the Medium Support Helicopter project, matching the term of the contract.

DEFERRED FINANCING COSTS

Costs incurred relating to the issuance of long-term debt are deferred and amortized over the term of the related debt.

INCOME TAXES

Future income taxes relate to the expected future tax consequences of differences between the carrying amount of balance sheet items and their corresponding tax values. A valuation allowance is recognized to the extent that, in the opinion of management, it is more likely than not that the future income tax assets will not be realized. Future income tax assets and liabilities are adjusted for the effects of subsequent changes in tax laws and rates on the date of enactment or substantive enactment.

Investment tax credits arising from research and development activities are deducted from the related costs and are accordingly included in the determination of earnings in the same year as the related costs. Investment tax credits arising from the acquisition of property, plant and equipment and deferred development costs are deducted from the cost of those assets with amortization calculated on the net amount.

The Company is subject to examination by taxation authorities in various jurisdictions. The determination of tax liabilities involved certain uncertainties in the interpretation of complex tax regulations. Therefore, the Company provides for potential tax liabilities based on management's best estimates. Differences between the estimates and the ultimate amounts of taxes and investment tax credits are recorded in earnings at the time they can be determined.

PENSIONS

The Company accrues its obligations under employee pension plans and the related costs, net of plan assets. The cost of pensions is actuarially determined using the projected benefits method calculated based on employee service, salary escalation and retirement age, together with the expected return on plan assets. For the purpose of calculating the expected return on plan assets, those assets are valued at fair market value.

The excess of the net actuarial gain (loss) over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the remaining service period of active employees.

STOCK-BASED COMPENSATION PLANS

The Company's stock-based compensation plans consist of an Employee Stock Option Plan (ESOP), an Employee Stock Purchase Plan (ESPP), a Deferred Share Unit (DSU) plan for executives and on April 1, 2003, the Company adopted a Long-Term Incentive Deferred Share Unit Plan (LTI-DSU), both of which (DSU and LTI-DSU) are described in note 12.

In fiscal 2004, the Company adopted on a prospective basis the CICA recommendations issued in June 2003 and expensed prospectively the cost of stock options granted to employees using the fair value based method. A compensation expense is recognized for the Company's portion of the contributions made under the ESPP and for amounts due under the DSU and LTI-DSU plans. In fiscal 2004, compensation cost for CAE's stock options was recognized in net earnings with a corresponding credit of $1.3 million to contributed surplus using the fair value method of accounting for awards that were granted in May 2003.

In fiscal 2003, CAE adopted the initial recommendations of CICA Section 3870, *Stock-based Compensation and Other Stock-based Payments*. The standard encouraged, but did not require, that the fair value based method for valuing stock options be used for transactions with employees. Under the fair value method, compensation expense is measured at the grant date and recognized over the service period. In note 12, pro forma net earnings and pro forma basic and diluted net earnings per share figures are presented as if the fair value based method of accounting had been used to account for stock options granted to employees during fiscal 2003. CAE's practice is to issue options in May of each fiscal year, whereby these options vest equally over four years. Any consideration paid by plan participants on the exercise of share options or the purchase of shares is credited to share capital together with any related stock-based compensation expense.

DERIVATIVE FINANCIAL INSTRUMENTS

The Company enters into forward, swap and option contracts to manage its exposure to fluctuations in interest rates and foreign exchange rates. CAE assesses on an ongoing basis whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. The Company does not hold or issue derivative financial instruments for speculative trading purposes.

The foreign currency risk associated with certain purchase and sale commitments denominated in a foreign currency is hedged through a combination of forward contracts and options. The foreign currency realized and unrealized gains or losses associated with derivative instruments, which have been terminated or cease to be effective prior to maturity, are deferred under other current, or non-current, assets or liabilities on the balance sheet and recognized in income in the period in which the underlying hedged transaction is recognized. In the event a designated hedged item is sold, extinguished or matures prior to the termination of the related derivative instrument, any realized or unrealized gain or loss on such derivative instrument is recognized in income.

Interest rate swap contracts are designated as hedges of the interest rate of certain financial instruments. The interest payments relating to swap contracts are recorded in net earnings over the life of the underlying transaction on an accrual basis as an adjustment to interest income or interest expense.

EARNINGS PER SHARE

The calculation of basic earnings per share is based on the weighted average number of shares issued and outstanding. Diluted earnings per share is calculated by dividing net earnings available to common shareholders by the weighted average number of shares used in the basic earnings per share calculation plus the number of common shares that would be issued assuming exercise or conversion of all dilutive potential common shares outstanding during the year using the treasury stock method.

USE OF ESTIMATES

The preparation of financial statements in conformity with GAAP requires 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 financial statements and the reported amounts of revenues and expenses for the period reported. Actual results could differ from those estimates.

RECENTLY ADOPTED ACCOUNTING STANDARDS

Impairment of long-lived assets

On April 1, 2003, the Company adopted CICA Handbook Section 3063, *Impairment of Long-Lived Assets,* which requires the recognition of an impairment loss for a long-lived asset to be held and used when events or changes in circumstances cause its carrying value to exceed the total undiscounted cash flows expected from its use and eventual disposition. An impairment loss, if any, is determined as the excess of the carrying value of the asset over its fair value. It replaces the impairment provision in Section 3061, *Property, Plant and Equipment*.

The adoption of this standard did not have any material effect on consolidated financial statements.

Disposal of long-lived assets and discontinued operations

On April 1, 2003, the Company adopted CICA Handbook Section 3475, *Disposal of Long-Lived Assets and Discontinued Operations* , which provides guidance on recognizing, measuring, presenting and disclosing long-lived assets to be disposed of. It supersedes the former Section 3475, *Discontinued Operations*.

Under this section, an asset classified as held for sale is measured at the lower of its carrying amount or fair value less disposal costs, and is not depreciated while classified as held for sale. The adoption of this standard did not have any material effect on CAE's consolidated financial statements.

Severance, termination benefits and costs associated with exit and disposal activities

On April 1, 2003, the Company prospectively adopted the new CICA Emerging Issues Committee Abstract 134 (EIC-134), *Accounting for Severance and Termination Benefits,* and EIC-135, *Accounting for Costs Associated with Exit and Disposal Activities (Including Costs Incurred in a Restructuring),* relating to exit or disposal activities after March 31, 2003. These abstracts provide guidance on the timing of recognition and measurement of liabilities as well as disclosures for the various types of severance and termination benefits related to the termination of employees' services prior to normal retirement and costs associated with an exit or disposal activity. Under this new guidance, liabilities for these costs are to be recognized in the period when they are incurred and measured at their fair value.

CAE applied these guidelines for severance and other costs as described in note 23.

FUTURE CHANGES TO ACCOUNTING STANDARDS

Hedging relationships

The CICA amended in November 2002 and June 2003 its Accounting Guideline (AcG-13), *Hedging Relationships*. It provides the views of the Accounting Standards Board on the identification, designation, documentation and effectiveness of hedging relationships for the purpose of applying hedge accounting, and the discontinuance of hedge accounting. Under this guideline, complete documentation of the information related to hedging relationships is required and the effectiveness of the hedges must be demonstrated and documented. This new Section is applicable for the Company on April 1, 2004.

On April 1, 2004, CAE will continue to apply hedge accounting in accordance with the requirements prescribed by the Guideline.

Consolidation of variable interest entities

In March 2004, the CICA issued proposed amendments to its Accounting Guideline (AcG-15) titled *Consolidation of Variable Interest Entities*. The resulting guideline will be harmonized with the recently issued US guidance (FIN 46R) (see note 24), and is expected to be applicable for interim and annual periods beginning on or after November 1, 2004. The guideline requires that an enterprise holding other than a voting interest in a Variable Interest Entity (VIE) could, subject to certain conditions, be required to consolidate the VIE if such enterprise is considered its primary beneficiary whereby it would absorb the majority of the VIE's expected losses and/or receive the majority of its expected residual returns. The Company is currently evaluating the impact of this draft guideline on its financial statements.

Employee future benefits

In December 2003, new disclosure requirements for pensions and other employee future benefits were issued. The new required disclosures include items such as a narrative description of each type of plan, the measurement date of the plan asset and liability, the effective date of the last actuarial evaluation, and the detail of the plan asset by major category. This requirement will be applicable for CAE in the first quarter of fiscal 2005.

Generally Accepted Accounting Principles and financial statement presentation

The CICA issued new Handbook Sections 1100, *Generally Accepted Accounting Principles,* and 1400, *General Standards of Financial Statement Presentation*. Section 1100 describes what constitutes Canadian GAAP and its sources, and provides guidance on sources to consult when selecting accounting policies and appropriate disclosure when a matter is not dealt with explicitly in the primary sources of GAAP, thereby recodifying the Canadian GAAP hierarchy. Section 1400 clarifies what is fair presentation in accordance with GAAP and provides general guidance on financial presentation. The Company does not expect any significant impact on its consolidated financial statements with the adoption on April 1, 2004 of this new Section.

NOTE 2 — BUSINESS ACQUISITIONS

On March 31, 2003, the Company completed a technology investment in the marine navigation business by acquiring all of the issued and outstanding shares of the Norway-based HiTec Marine Automation AS (HiTec). No consideration was given for the purchase of the shares. The business provides marine navigation products and capabilities for both naval and commercial marine markets. This technology investment complements the Company's existing marine products and capabilities.

During fiscal 2002, the Company completed four strategic acquisitions, two of which accelerated the Company's move into aviation training, one which significantly improved the Company's access to the US defence market and one which provided immediate entry into the commercial marine control systems market. A summary description of each acquisition follows: On April 2, 2001, the Company acquired all of the issued and outstanding shares of BAE Systems Flight Simulation and Training Inc. (BAE Systems) located in Tampa, Florida, for a total cash consideration of US$76.0 million. The business has a well-established position in the US defence market for the manufacture of transport and helicopter simulation equipment and has significant training and support service activities for both civil and military markets.

On August 1, 2001, the Company acquired all of the issued and outstanding shares of Valmarine AS of Norway (Valmarine), for a cash consideration of NOK238.6 million and a CAE share issuance of NOK125.4 million (or 1,419,919 common shares), based on the average closing price of CAE's shares for the 10 days prior to August 1. Valmarine is the global leader for marine control systems for the commercial market.

On August 24, 2001, the Company acquired all of the issued and outstanding shares of the Netherland-based Schreiner Aviation Training B.V. (Schreiner) for total cash consideration of €193.4 million. The business provides simulator and ground-school civil aviation training.

On December 31, 2001, the Company acquired all of the issued and outstanding shares of SimuFlite Training International Inc. (SimuFlite), based in Dallas, Texas, for a total cash consideration of US$210.9 million. In addition, equipment in the amount of US$54.0 million was sold and leased back. SimuFlite is the world's second largest provider of business aviation training.

These acquisitions were accounted for under the purchase method and their operating results have been included from the respective acquisition dates.

The net assets acquired are summarized as follows:

	2003	2002				
(amounts in millions of Canadian dollars)	HiTec Marine Automation	BAE Systems	Valmarine	Schreiner	SimuFlite	Total
Current assets	$ 5.6	$ 36.2	$ 16.3	$ 15.3	$ 23.0	$ 90.8
Current liabilities	(13.3)	(65.8)	(8.7)	(37.0)	(8.2)	(119.7)
Property, plant and equipment	0.1	59.0	0.5	167.9	262.0	489.4
Intangible assets						
Trade names	—	—	3.2	—	37.1	40.3
Customer relations	—	—	9.8	66.0	29.2	105.0
Customer contractual agreements	—	—	2.3	2.2	3.6	8.1
Other intangibles	1.2	2.5	3.1	—	7.0	12.6
Goodwill	1.6	104.2	40.4	102.8	106.3	353.7
Future income taxes	4.8	36.6	(3.9)	(34.2)	15.1	13.6
Long-term debt	—	(17.3)	—	(23.1)	(52.4)	(92.8)
Long-term liabilities	—	(36.1)	—	—	—	(36.1)
	—	119.3	63.0	259.9	422.7	864.9
Less: Sale and leaseback of assets	—	—	—	—	(86.2)	(86.2)
Shares issued (note 11)	—	—	(21.1)	—	—	(21.1)
Total cash consideration:	$ —	$ 119.3	$ 41.9	$ 259.9	$ 336.5	$ 757.6

The net assets of Schreiner, SimuFlite and approximately 10% of the net assets of BAE Systems are included in the Civil Simulation and Training segment. The balance of the net assets of BAE Systems is included in the Military Simulation and Training segment. Net assets of Valmarine and HiTec are included in the Marine Controls segment.

The goodwill on the SimuFlite acquisition is the sole deductible goodwill for tax purposes.

There were certain adjustments to the assets and liabilities recorded in fiscal 2003 for certain of the businesses acquired. For Valmarine, the adjustment related to the final evaluation of other intangible assets. For Schreiner, the adjustment pertained to the accounting for simulators that were being built at the time the acquisition was completed. For SimuFlite, the adjustment resulted from a purchase price arbitration settlement. HiTec Marine Automation was adjusted in fiscal 2004, with the final evaluation of the tax liabilities and integration costs.

The adjustments to the purchase price equation are summarized as follows:

	2004	2003			
(amounts in millions of Canadian dollars)	HiTec Marine Automation	Valmarine AS	Schreiner	SimuFlite	Total
Current assets	**$ —**	$ (0.1)	$ —	$ (2.7)	$ (2.8)
Current liabilities	**0.7**	—	(0.1)	(6.0)	(6.1)
Property, plant and equipment	**—**	—	—	3.2	3.2
Intangible assets	**—**	7.3	—	—	7.3
Goodwill	**(0.7)**	(2.9)	(11.6)	1.9	(12.6)
Future income taxes	**—**	(4.3)	(2.2)	—	(6.5)
Long-term debt	**—**	—	13.9	(3.3)	10.6
Total cash consideration:	**$ —**	$ —	$ —	$ (6.9)	$ (6.9)

NOTE 3 — DISCONTINUED OPERATIONS

CLEANING TECHNOLOGIES

On February 28, 2002, the Company completed the sale of two of CAE's five Cleaning Technologies operations. The Company sold the shares of CAE Ransohoff Inc., ("Ransohoff") of Cincinnati, Ohio and CAE Ultrasonics Inc., of Jamestown, New York to the management of these operations. The total consideration was initially US$21.4 million, comprising US$9.2 million cash and a holdback of US$1.6 million payable 120 days from closing with the balance in the form of long-term subordinated notes receivable. In fiscal 2003, the total consideration was reduced by US$2.2 million based on an audit of the closing statement of financial position.

On June 28, 2002, CAE sold the shares of CAE Cleaning Technologies Plc to the management of Ransohoff for a note receivable of $1.2 million (£0.5 million).

On April 30, 2003, CAE completed the sale of certain assets of its German Cleaning Technologies operations for a cash consideration of €25,000, approximating book value. Subsequent to completing the sale, CAE incurred post-disposition costs with respect to the transfer of employees, resulting in a charge recorded in its results of Discontinued Operations of $2.6 million, net of income taxes — $1.7 million.

On July 31, 2003, CAE completed the sale of substantially all the assets of its last remaining Cleaning Technology business, Alpheus Inc. to Cold Jet Inc. of Cincinnati, Ohio. The total consideration, after completion of the closing date audit of assets being sold was US$2.1 million. Of this amount, US$1.5 million has been received and the balance, US$0.6 million is due on the first anniversary from closing, July 31, 2004. In addition, the company is entitled to receive further consideration of US$1.0 million based on the future performance of the combined businesses over the 53-month period from closing. No value has been ascribed in these financial statements to this additional consideration.

FORESTRY SYSTEMS

On March 28, 2002, CAE completed the sale of its fibre screening business to the Advanced Fiber Income Fund (AFT) for cash proceeds of $162.0 million. Following the closing of this transaction, certain additional costs were incurred over the amounts estimated when the transaction was completed. As a result, CAE recorded in its loss from Discontinued Operations in fiscal 2003, an additional after tax cost of $3.2 million (income taxes — $1.1 million) for these adjustments.

On August 16, 2002, CAE sold substantially all the assets of the sawmill division of its Forestry Systems segment for cash consideration of $25.0 million and a further estimated payment at $10.0 million, included in other assets, based on the operating performance of the company in the three-year period following the closing date.

On May 2, 2003, CAE completed the sale of its remaining Forestry Systems business to Carmanah Design and Manufacturing Inc. for a total cash consideration of $20.3 million. The Company is entitled to receive further consideration based on the performance of the business over the 30-month period following the closing. No value has been ascribed to this additional consideration in these financial statements.

Summarized financial information for the discontinued operations is as follows:

(amounts in millions of Canadian dollars)	2004	2003	2002
Revenue			
Cleaning Technologies	**$ 1.7**	$ 72.0	$ 86.5
Forestry Systems	**3.1**	20.8	193.5
	$ 4.8	$ 92.8	$ 280.0
Net earnings from Forestry Systems prior to measurement date, net of taxes (2002 — $4.0)	**$ —**	$ —	$ 8.5
Net (loss) gain from Forestry Systems after measurement date, net of taxes (2004 — $0.2; 2003 — $3.0; 2002 — $15.2)	**(0.5)**	(7.2)	17.7
Net loss from Cleaning Technologies after measurement date, net of taxes (2004 — $1.7; 2003 — $7.7; 2002 — $7.3)	**(2.6)**	(6.6)	(25.1)
Net (loss) earnings from discontinued operations	**$ (3.1)**	$ (13.8)	$ 1.1

	2004		2003	
(amounts in millions of Canadian dollars)	Forestry Systems	Cleaning Technologies	Forestry Systems	Cleaning Technologies
Current assets	**$ —**	**$ —**	$ 11.5	$ 7.9
Property, plant and equipment, net	**—**	**—**	2.7	3.7
Goodwill	**—**	**—**	16.0	4.8
Other assets	**—**	**—**	0.8	2.6
	$ —	**$ —**	$ 31.0	$ 19.0
Assets of discontinued operations		**$ —**		$ 50.0
Current liabilities	**$ —**	**$ —**	$ 12.8	$ 0.1
Other liabilities	**—**	**—**	0.9	4.1
	$ —	**$ —**	$ 13.7	$ 4.2
Liabilities of discontinued operations		**$ —**		$ 17.9

NOTE 4 — ACCOUNTS RECEIVABLE

(amounts in millions of Canadian dollars)	2004	2003
Trade	**$ 146.1**	$ 126.1
Allowance for doubtful accounts	**(8.1)**	(12.1)
Unbilled receivables	**206.4**	189.7
Other receivables	**46.5**	69.4
	$ 390.9	$ 373.1

Approximately $5.9 million of the March 2004 unbilled receivables are not expected to be recovered within one year (2003 — $6.0 million).

NOTE 5 — INVENTORIES

(amounts in millions of Canadian dollars)	2004	2003
Work-in-progress	**$ 114.8**	$ 115.3
Raw materials, supplies and manufactured products	**40.0**	21.0
	$ 154.8	$ 136.3

NOTE 6 — PROPERTY, PLANT AND EQUIPMENT

(amounts in millions of Canadian dollars)	2004 Cost	2004 Accumulated Amortization	2004 Net Book Value	2003 Cost	2003 Accumulated Amortization	2003 Net Book Value
Land	**$ 19.7**	**$ —**	**$ 19.7**	$ 19.2	$ —	$ 19.2
Buildings and improvements	**254.7**	**60.6**	**194.1**	247.9	50.6	197.3
Machinery and equipment	**169.0**	**127.8**	**41.2**	175.4	117.6	57.8
Simulators	**493.0**	**39.8**	**453.2**	527.4	37.2	490.2
Assets under construction						
Buildings	**4.6**	**—**	**4.6**	2.1	—	2.1
Equipment	**130.2**	**—**	**130.2**	163.8	—	163.8
	$ 1,071.2	**$ 228.2**	**$ 843.0**	$ 1,135.8	$ 205.4	$ 930.4

Amortization of property, plant and equipment was $53.5 million in 2004 (2003 — $52.1 million, 2002 — $37.0 million).

NOTE 7 — INTANGIBLE ASSETS

(amounts in millions of Canadian dollars)	2004 Cost	2004 Accumulated Amortization	2004 Net Book Value	2003 Cost	2003 Accumulated Amortization	2003 Net Book Value
Trade names	**$ 34.6**	**$ 3.6**	**$ 31.0**	$ 38.5	$ 2.3	$ 36.2
Customer relations	**108.5**	**11.0**	**97.5**	111.3	6.8	104.5
Customer contractual agreements	**11.5**	**2.3**	**9.2**	14.3	1.7	12.6
Other intangible assets	**21.7**	**4.2**	**17.5**	20.8	2.4	18.4
	$ 176.3	**$ 21.1**	**$ 155.2**	$ 184.9	$ 13.2	$ 171.7

The continuity of intangible assets is as follows:

(amounts in millions of Canadian dollars)	2004 Civil Simulation and Training	2004 Military Simulation and Training	2004 Marine Controls	2004 Total	2003 Civil Simulation and Training	2003 Military Simulation and Training	2003 Marine Controls	2003 Total
Beginning balance	**$ 140.1**	**$ 2.1**	**$ 29.5**	$ 171.7	$ 141.5	$ 2.5	$ 19.4	$ 163.4
Additions	**0.6**	**—**	**—**	0.6	1.8	—	1.2	3.0
Purchase price adjustment (note 2)	**—**	**—**	**—**	—	—	—	7.3	7.3
Amortization	**(6.8)**	**(0.1)**	**(1.9)**	(8.8)	(7.5)	(0.2)	(2.0)	(9.7)
Foreign exchange	**(6.6)**	**(0.2)**	**(1.5)**	(8.3)	4.3	(0.2)	3.6	7.7
Ending balance	**$ 127.3**	**$ 1.8**	**$ 26.1**	$ 155.2	$ 140.1	$ 2.1	$ 29.5	$ 171.7

The yearly amortization expense for the five following years will be approximately $8.8 million.

NOTE 8 — GOODWILL

The continuity of goodwill by reportable segment is as follows:

(amounts in millions of Canadian dollars)	Civil Simulation and Training	Military Simulation and Training	Marine Controls	2004 Total	Civil Simulation and Training	Military Simulation and Training	Marine Controls	2003 Total
Beginning balance	**$ 212.9**	**$ 107.6**	**$ 46.3**	$ 366.8	$ 217.8	$ 114.7	$ 43.0	$ 375.5
Additions	**—**	**—**	**—**	—	—	—	1.6	1.6
Purchase price adjustment (note 2)	**—**	**—**	**(0.7)**	(0.7)	(9.7)	—	(2.9)	(12.6)
Foreign exchange	**(12.5)**	**(7.4)**	**(2.4)**	(22.3)	4.8	(7.1)	4.6	2.3
Ending balance	**$ 200.4**	**$ 100.2**	**$ 43.2**	$ 343.8	$ 212.9	$ 107.6	$ 46.3	$ 366.8

NOTE 9 — OTHER ASSETS

(amounts in millions of Canadian dollars)	2004	2003
Investment in and advances to CVS Leasing Ltd. (i)	**$ 49.1**	$ 43.7
Deferred development costs net of $5.6 million accumulated amortization (2003 — $0.2 million) (ii)	**41.3**	37.6
Deferred pre-operating costs net of $8.5 million accumulated amortization (2003 — $4.4 million)	**27.7**	27.7
Long-term receivables (iii)	**18.4**	15.1
Deferred financing costs net of $5.7 million accumulated amortization (2003 — $2.1 million)	**11.7**	12.7
Other	**20.2**	28.4
	$ 168.4	$ 165.2

(i) The Company led a consortium which was contracted by the UK Ministry of Defence (MoD) to design, construct, manage, finance and operate an integrated simulator-based aircrew training facility for the Medium Support Helicopter fleet of the Royal Air Force. The contract covers a 40-year period, which can be terminated by the MoD after 20 years, in 2018.

In connection with the contract, the Company has established a subsidiary, CAE Aircrew Training Plc (Aircrew), of which it owns 78% with the balance held by the other consortium partners. This subsidiary has leased the land from the MoD, has built the facility and operates the training centre, and has been consolidated with the accounts of the Company.

In addition, the Company has a minority shareholding of 14% in, and has advanced funds to, CVS Leasing Ltd. (CVS), a company established to acquire the simulators and other equipment that are leased to Aircrew. CVS obtained project financing, which amounts to £65.0 million at March 31, 2004, and expires in October 2015. This financing is secured solely by the assets of CVS with no recourse to CAE.

(ii) Research and development expenditures aggregated $93.6 million during the year (2003 — $115.2 million, 2002 — $104.7 million) of which $12.7 million representing qualifying development costs pursuant to CICA requirements (2003 — $13.7 million, 2002 — $30.1 million) was deferred and amortized. The Company has received government assistance of $13.9 million related to research and development expenditures during the year (2003 — $32.5 million, 2002 — $15.8 million), of which $2.3 million (2003 — $2.3 million, 2002 — $9.5 million) was recorded against deferred costs incurred to develop new products and $1.8 million (2003 — nil, 2002 — nil) was recorded against machinery and equipment with the balance being accounted for as a reduction of research and development expenses.

(iii) The Company has established secured subordinated promissory notes in connection with the sale of its various Cleaning Technologies businesses totalling $13.0 million. The notes bear interest at rates ranging from 3% to 7%. Principal repayments commence in fiscal 2005 and extend to fiscal 2011.

NOTE 10 — DEBT FACILITIES
A. LONG-TERM DEBT

(amounts in millions of Canadian dollars unless otherwise indicated)		2004	2003
(i)	Senior notes	**$ 161.5**	$ 178.7
(ii)	Revolving unsecured term credit facilities, 5 years maturing April 2006, US $350.0 and €100.0 (outstanding March 31, 2004 — $181.4, US$70.0 and €20.0, March 31, 2003 — $114.0 and US $195.0)	**305.3**	400.5
(iii)	18 months, matured June 2003, US$135.0 (outstanding March 31, 2004 — nil, March 31, 2003 — US$35.0)	**—**	51.4
(iv)	Term loan, maturing in April 2009 (outstanding March 31, 2004 — US$28.2, March 31, 2003 — US$32.5)	**37.0**	47.8
(v)	Term loan of £12.7, secured, maturing in October 2015 (outstanding March 31, 2004 — £8.9, March 31, 2003 — £10.1)	**21.4**	23.5
(vi)	Grapevine Industrial Development Corporation bonds, secured (US$27.0)	**35.4**	39.7
(vii)	Term loan of £31.8, secured, maturing September 2029 (outstanding March 31, 2004 — £21.8, March 31, 2003 — £17.5)	**52.6**	40.7
(viii)	Obligations under capital lease commitments	**23.7**	29.1
		636.9	811.4
Less: Long-term debt due within one year		**13.5**	13.4
		$ 623.4	$ 798.0

(i) Pursuant to a private placement, the Company borrowed US$108.0 million and $20.0 million. These unsecured senior notes rank equally with term bank financings with fixed repayment amounts of $20.0 million in 2005, US$15.0 million in 2007, US$60.0 million in 2009 and US$33.0 million in 2012. Fixed interest is payable semi-annually in June and December at an average rate of 7.6% on the US amounts and 7.2% on the Canadian amount. The Company has entered into interest rate swap agreements converting the fixed interest rate into the equivalent of a three-month LIBOR borrowing plus 3.6% on US$33.0 million of the senior notes.

(ii) These facilities (US$350.0 million and €100.0 million) are unsecured and the interest rate payable is based on LIBOR, BAs or EURIBOR plus 0.6%. As at the end of both fiscal years, an amount of $35.0 million has been fixed through a swap agreement until April 2006 at a rate of 5.0%. The facility of €100.0 million was not used as of March 31, 2003. The average interest rate at March 31, 2004 is 3.4% (2003 — 2.4%).

(iii) The revolving credit facility of US$200.0 million which expired in June 2003 was unsecured and the interest rate payable was based on LIBOR plus 0.50%. This facility was repaid and cancelled in June 2003.

(iv) The Company arranged project financing for its training centre in Sao Paulo, Brazil. This term loan is supported by a letter of credit for an amount equal to the outstanding obligations and is repayable semi-annually until April 30, 2009. This letter of credit replaces a pledge of the training assets (net book value of US$50.0 million) in place at March 31, 2003. Interest on the loan is charged at a rate of approximately 7.7%.

(v) The Company arranged project financing for one of its subsidiaries to finance the Company's Medium Support Helicopter program for the MoD in the United Kingdom. The credit facility includes a term loan that is secured by the project assets of the subsidiary and a bi-annual repayment is required until 2015. The facility also includes a standby loan of £4.0 million and a working capital loan of £1.0 million, both maturing in October 2015. Interest on the loans is charged at a rate approximating LIBOR plus 1%. The Company has entered into interest rate swaps totalling $22.0 million (£9.1 million) fixing the interest rate at approximately 6.8%. The value of the assets pledged as collateral for the credit facility as at March 31, 2004 is $66.3 million (£27.5 million) (2003 — $59.9 million or £25.8 million (note 9 (i)).

(vi) Airport Improvement Revenue Bonds were issued by the Grapevine Industrial Development Corporation, Grapevine, Texas for amounts of US$8.0 million and US$19.0 million and maturing respectively in 2010 and 2013. Real property improvements, fixtures and specified simulation equipment secure the bonds. The rates are set periodically by the remarketing agent based on market conditions. For the bonds maturing in 2010, the rate is set weekly and yearly. For the bonds maturing in 2013, the rates are subject to a maximum rate of 10% permissible under current applicable laws. As at March 31, 2004, the combined rate for both series was approximately 1.15%. The security is limited to an amount not exceeding the outstanding balance of the loans which represents US$27.0 million as at March 31, 2004. Also, a letter of credit has been issued to support the bonds for the outstanding amount of the loans.

(vii) The Company, in association with two other partners, arranged project financing for the delivery of training services on the Astute Class Submarine for the MoD in the United Kingdom. The Company's participation is 50%. The secured loans consist of a loan of £31.8 million split into three sections, a term loan expiring September 2029, an Equity Bridge loan expiring September 2029 and a Ramp Up Facility expiring August 2004. Interest payable amounts are based on LIBOR plus 0.60% for the term loan and the Equity Bridge loan and LIBOR plus 1.75% for the Ramp Up Facility. The loans are secured by fixed and floating charges over property and assets of the joint venture. The value, at CAE's participation of 50%, of the assets pledged is $50.2 million (£20.8 million) as at March 31, 2004 (2003 — $39.9 million or £17.2 million).

(viii) These capital leases are related to the leasing of various simulators in CAE's subsidiaries. The cost associated with these simulators is $35.6 million (2003 — $41.1 million) and the accumulated amortization as at March 31, 2004 is $23.8 million (2003 — $19.5 million) for a net book value of $11.8 million (2003 — $21.6 million). The effective interest rate on obligations under capital leases which mature from June 2004 to March 2024 was approximately 5.0% (2003 — 5.1%).

(ix) Payments required in each of the next five fiscal years to meet the retirement provisions of the long-term debt are as follows:

(amounts in millions of Canadian dollars)	
2005	$ 13.5
2006	31.4
2007	316.4
2008	32.0
2009	10.4
Thereafter	233.2
	$ 636.9

Details of interest on debt are as follows:

(amounts in millions of Canadian dollars)	2004	2003	2002
Long-term debt interest expense	**$ 32.8**	$ 37.1	$ 30.3
Short-term debt interest expense	**0.5**	0.2	1.9
Other financing charges	**3.1**	3.1	1.4
Allocation of interest expense to discontinued operations	**—**	(0.1)	(3.6)
Interest capitalized	**(6.4)**	(6.2)	(3.9)
Interest on debt	**$ 30.0**	$ 34.1	$ 26.1

Certain of the Company's debt instruments include customary positive and negative covenants, including interest coverage, leverage ratios, and restrictions on the sale of assets. At March 31, 2004, the Company is in compliance with its debt covenants.

B. SHORT-TERM DEBT

The Company has unsecured bank lines of credit available in various currencies totalling $28.2 million, of which $6.4 million was used as at March 31, 2004. The effective rate on the short-term borrowings was 4.0% (2003 — 4.8%, 2002 — 5.6%).

NOTE 11 — CAPITAL STOCK

(i) The Company's articles of incorporation authorize the issuance of an unlimited number of preferred shares, issuable in series, and an unlimited number of common shares. To date, the Company has not issued any preferred shares.

(ii) A reconciliation of the issued and outstanding common shares of the Company is as follows:

	2004		2003		2002	
	Number of Shares	Stated Value	Number of Shares	Stated Value	Number of Shares (c)	Stated Value
Balance at beginning of year	**219,661,178**	**$ 190.5**	218,955,780	$ 186.8	216,399,856	$ 159.4
Stock options exercised	**282,000**	**1.4**	650,776	3.5	1,118,400	6.1
Stock dividends (a)	**106,002**	**0.6**	54,622	0.2	17,605	0.2
Shares issued (b)	**26,600,000**	**175.0**	—	—	1,419,919	21.1
Balance at end of year	**246,649,180**	**$ 367.5**	219,661,178	$ 190.5	218,955,780	$ 186.8

(a) Until February 29, 2004, the Company's Dividend Reinvestment Plan (DRIP) provided that eligible shareholders (which covered all shareholders living wherever the shares were distributed) could elect to receive common stock dividends in lieu of cash dividends. As of March 1, 2004, eligibility has been limited to Canadian resident shareholders.

(b) On September 30, 2003, the Company issued 26,600,000 common shares at a price of $6.58 per share, for cash proceeds of $175.0 million.

(c) On June 20, 2001, the Board of Directors declared a 100% stock dividend in respect of the common shares in the capital of the Company, effectively achieving a two-for-one split of CAE's outstanding common shares. The stock dividend was payable to shareholders of record at the close of business on July 9, 2001, on the basis of one additional share for each common share held as of the Record Date. CAE's common shares commenced trading on a split basis on July 5, 2001 on the Toronto Stock Exchange. The Company ascribed no monetary value to the stock dividend. The number of shares and options, the option exercise prices and the basic and diluted net earnings per share figures have been restated retroactively to reflect the stock dividend.

(d) The following is a reconciliation of the denominators for the basic and diluted earnings per share computations:

	2004	2003	2002
Weighted average number of common shares outstanding — Basic	**233,167,858**	219,427,513	217,592,039
Effect of dilutive stock options	**849,912**	897,806	2,544,722
Weighted average number of common shares outstanding — Diluted	**234,017,770**	220,325,319	220,136,761

Options to acquire 4,195,400 common shares (2003 — 3,198,000, 2002 — 1,474,628) have been excluded from the above calculation since their inclusion would have an anti-dilutive effect.

NOTE 12 — STOCK-BASED COMPENSATION PLANS

EMPLOYEE STOCK OPTION PLAN

Under the long-term incentive program of the Company, options may be granted to officers and other key employees of the Company and its subsidiaries to purchase common shares of the Company at a subscription price of 100% of market value. Market value is determined as the closing price of the common shares on the Toronto Stock Exchange on the last day of trading prior to the effective date of the grant.

At March 31, 2004, a total of 11,530,046 common shares remained authorized for issuance under the Plan. The options are exercisable during a period not to exceed six years and are not exercisable during the first 12 months after the date of the grant. The right to exercise all of the options accrues over a period of four years of continuous employment. However, if there is a change of control of the Company, the options become immediately exercisable. Options are adjusted proportionately for any stock dividends or stock splits attributed to the common shares of the Company.

A reconciliation of the outstanding options is as follows:

	2004		2003		2002	
For the years ended March 31	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Options outstanding at beginning of year	**5,692,750**	**$ 9.37**	4,999,078	$ 7.70	5,114,350	$ 5.70
Granted	**3,536,320**	**$ 4.14**	1,767,000	$ 12.71	1,698,012	$ 12.19
Exercised	**(282,000)**	**$ 4.88**	(650,776)	$ 5.62	(1,118,400)	$ 5.41
Forfeited	**(718,400)**	**$ 6.98**	(325,400)	$ 9.38	(692,884)	$ 7.71
Expired	**(100,300)**	**$ 5.70**	(97,152)	$ 9.10	(2,000)	$ 12.23
Options outstanding at end of year	**8,128,370**	**$ 7.51**	5,692,750	$ 9.37	4,999,078	$ 7.70
Options exercisable at end of year	**2,887,000**	**$ 8.07**	2,000,975	$ 6.78	1,417,878	$ 5.70

The following table summarizes information about the Company's Employee Stock Option Plan as at March 31, 2004:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$4.08 to $5.07	**3,932,970**	**4.39**	**$ 4.14**	**793,250**	**$ 4.18**
$6.03 to $9.20	**1,379,650**	**1.79**	**$ 6.85**	**1,081,500**	**$ 6.82**
$12.25 to $14.60	**2,815,750**	**3.73**	**$ 12.53**	**1,012,250**	**$ 12.45**
Total	**8,128,370**	**3.72**	**$ 7.51**	**2,887,000**	**$ 8.07**

The assumptions used for purposes of the option calculations outlined in this note are presented below:

	2004	2003
Assumptions used in Black-Scholes options pricing model:		
Dividend yield	**1.290%**	1.058%
Expected volatility	**41.5%**	46.5%
Risk-free interest rate	**5.75%**	5.26%
Expected life (years)	**6**	6
Weighted average fair value of options granted	**$ 1.65**	$ 5.84

DISCLOSURE OF PRO FORMA INFORMATION REQUIRED UNDER CICA HANDBOOK SECTION 3870

During the year ended March 31, 2003, the Company granted 1,767,000 options to purchase common shares. The weighted average grant date fair value of options granted during this period amounted to $5.84 per option. To compute the pro forma compensation cost, the Black-Scholes valuation model was used to determine the fair value of the options granted. Pro forma net earnings and pro forma basic and diluted net earnings per share are presented below:

(amounts in millions of Canadian dollars, except per share amounts)	2004	2003
Net earnings, as reported	**$ 64.0**	$ 117.2
Pro forma impact	**$ (2.5)**	$ (2.5)
Pro forma net earnings	**$ 61.5**	$ 114.7
Pro forma basic and diluted net earnings per share	**$ 0.26**	$ 0.52

EMPLOYEE STOCK PURCHASE PLAN

The Company maintains an Employee Stock Purchase Plan (ESPP) to enable employees of the Company and its participating subsidiaries to acquire CAE common shares through regular payroll deductions plus employer contributions. The Plan allows employees to contribute up to 10% of their annual base salary. The Company and its participating subsidiaries match the first $500 employee contribution and contribute $1 for every $3 on additional employee contributions, to a maximum of 2% of the employee's base salary. Matching contributions vest at the beginning of the third year following the year during which the employee contributions were made, provided employment has been continuous during that period. Common shares of the Company are purchased by the ESPP trustee on behalf of the participants on the open market, through the facilities of the Toronto Stock Exchange. The Company recorded compensation expense in the amount of $1.6 million (2003 — $1.9 million, 2002 — $1.9 million) in respect of employer contributions under the Plan.

DEFERRED SHARE UNIT PLAN

Effective May 1, 2000, the Company adopted a Deferred Share Unit (DSU) Plan for executives whereby an executive may elect to receive any cash incentive compensation in the form of deferred share units. The Plan is intended to enhance the Company's ability to promote a greater alignment of interests between executives and the shareholders of the Company. A deferred share unit is equal in value to one common share of the Company. The units are issued on the basis of the average closing board lot sale price per share of CAE common shares on the Toronto Stock Exchange during the last 10 days on which such shares traded prior to the date of issue. The units also accrue dividend equivalents payable in additional units in an amount equal to dividends paid on CAE common shares. Deferred share units mature upon termination of employment, whereupon an executive is entitled to receive the fair market value of the equivalent number of common shares, net of withholdings, in cash.

In fiscal 2000, the Company adopted a DSU Plan for non-employee directors. A non-employee director holding less than 10,000 common shares of the Company receives the Board retainer and attendance fees in the form of deferred share units. A non-employee director holding at least 10,000 common shares may elect to participate in the Plan in respect of part or all of his or her retainer and attendance fees. The terms of the Plan are essentially identical to the key executive DSU Plan except that the share price used to value the deferred share unit is based on the closing price per share of CAE common shares on the Toronto Stock Exchange on the day preceding the last business day of March, June, September and December.

The Company records the cost of the DSU plan as compensation expense. As at March 31, 2004, 403,071 units were outstanding at a value of $2.3 million (2003 — 362,498 units at a value of $1.0 million; 2002 — 194,581 units at a value of $2.3 million). A total number of 36,978 units were redeemed during the fiscal year ended March 31, 2004 under both DSU plans in accordance with their respective plan text, for a total of $0.2 million. As at March 31, 2004 no DSU were cancelled.

LONG-TERM INCENTIVE — DEFERRED SHARE UNIT PLAN

During the year ended March 31, 2004, the Company adopted, as an element of its long-term incentive compensation plan, long-term deferred share units (LTI-DSU). This LTI-DSU partially replaced the grant of options under the Company's Stock Option Plan. LTI-DSUs have been granted to executives and managers of the Company. An LTI-DSU is equal in value to one common share of the Company based on quoted market value of the enterprise shares at a specific date, and subject to the Company plan. The LTI-DSU also accrued dividend equivalents payable in additional units in an amount equal to dividends paid on CAE common shares. The LTI-DSU vest equally over four years and can be redeemed for value upon retirement, death, disability or involuntary termination. The value is equal to the fair market value of the equivalent number of common shares of the Company, net of withholdings, in cash. In May 2003, the Company issued 1,441,011 LTI-DSU units. The expense recorded in fiscal 2004 with respect to these units was $1.4 million. On March 15, 2004, the Company entered into a hedging contract

to reduce its earnings exposure to the fluctuations in the Company's share price (see note 13).

NOTE 13 — FINANCIAL INSTRUMENTS

FOREIGN CURRENCY RISK

The Company entered into forward foreign exchange contracts totalling $210.9 million (buy contracts $13.8 million and sell contracts $197.1 million). The total unrealized gain as of March 31, 2004, is $1.6 million (on buy contracts $0.7 million and on sell contracts $0.9 million).

CONSOLIDATED FOREIGN EXCHANGE DEALS OUTSTANDING

(amounts in millions of Canadian dollars)	2004		2003	
Currencies (Sold/Bought)	Notional Amount[1]	Average Rate	Notional Amount[1]	Average Rate
US/CA				
Less than 1 year	**96.5**	**0.7594**	20.6	0.6222
Between 1 and 3 years	**18.5**	**0.7569**	—	—
CA/US				
Less than 1 year	**11.8**	**1.3145**	4.4	1.4842
US/EUR				
Less than 1 year	**1.9**	**1.2294**	21.2	1.0376
Between 1 and 3 years	**—**	**—**	1.9	0.8785
CA/EUR				
Less than 1 year	**—**	**—**	20.9	1.6168
EUR/CA				
Less than 1 year	**5.6**	**0.6180**	7.8	0.6168
Between 1 and 3 years	**11.3**	**0.6007**	7.8	0.6028
Between 3 and 5 years	**—**	**—**	6.7	0.5891
GBP/CA				
Less than 1 year	**9.3**	**0.4215**	10.5	0.4404
Between 1 and 3 years	**4.3**	**0.4326**	1.1	0.4606
GBP/US				
Less than 1 year	**51.7**	**0.5482**	—	—
	210.9		102.9	

1 Exchange rates as at the end of the respective fiscal year were used to translate amounts in foreign currencies.

CREDIT RISK

The Company is exposed to credit risk on billed and unbilled accounts receivable. However, its customers are primarily established companies with publicly available credit ratings or government agencies, factors that facilitate the monitoring of the risks. In addition, the Company typically receives substantial non-refundable deposits on contracts. The Company closely monitors its exposure to major airlines in order to curtail it to the extent possible.

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.

INTEREST RATE EXPOSURE

The Company bears some interest rate fluctuation risk on its variable rate long-term debt and some fair value risk on its fixed rate long-term debt. As at March 31, 2004, the Company has entered into five interest rate swap agreements with three different financial institutions to mitigate these risks for a total notional value of $114.6 million. One agreement, with a notional value of $43.2 million (US$33.0 million), has converted fixed interest rate debt into floating whereby the Company pays the equivalent of a three-month LIBOR borrowing rate plus 3.6% and receives a fixed interest rate of 7.8% up to June 2012. The remaining four contracts are converting floating interest rate debt into fixed for a notional value of $71.3 million whereby the Company will receive quarterly LIBOR and pay fixed interest payments as follows:

- until April 2006 on $35.0 million, the Company will pay quarterly a fixed interest rate of 5.0%;
- until September 2005 on $14.4 million (US$11.0 million), the Company will pay monthly a fixed annual interest rate of 5.0%;
- until October 2011 on two contracts totalling $21.9 million (£9.1 million), the Company will pay quarterly fixed annual interest rate of 6.8%.

After considering these swap agreements, as at March 31, 2004, 45% of the long-term debt bears fixed interest rates.

STOCK BASED COMPENSATION COST

In March 2004, the Company entered into an equity swap agreement with a major Canadian institution to reduce its cash and earnings exposure to fluctuation in the Company's share price relating to the DSU and LTI-DSU programs. Pursuant to the agreement, the Company receives on a monthly basis the economic benefit of dividends and share price appreciation while providing payments to the financial institution for the institution's cost of funds and any share price depreciation. The net effect of the equity swap partially offsets movements in the Company's share price impacting the cost of the DSU and LTI-DSU programs. As at March 31, 2004, the equity swap agreement covered 700,000 shares of the Company.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions have been used to estimate the fair value of the financial instruments:

- cash and short-term investments, accounts receivable, accounts payable and accrued liabilities are valued at their carrying amounts on the balance sheet, which represent an appropriate estimate of their fair values due to their near-term maturities;
- capital leases are valued using the discounted cash flow method;
- long-term debt value is estimated based on discounted cash flows using current interest rates for debt with similar terms and remaining maturities;
- interest rate and currency swap contracts reflect the present value of the potential gain or loss if settlement were to take place at the balance sheet date;
- the forward foreign exchange contracts are represented by the estimated amounts that the Company would receive or pay to settle the contracts at the balance sheet date.

The fair value and the carrying amount of the financial instruments as at March 31 is as follows:

	2004		2003	
(amounts in millions of Canadian dollars)	**Fair Value**	**Carrying Amount**	**Fair Value**	**Carrying Amount**
Long-term debt	**$ 664.6**	**$ 636.9**	$ 837.8	$ 811.4
Net forward foreign exchange contracts	**1.6**	**—**	2.7	—
Interest rate swap contracts	**(2.6)**	**—**	(10.3)	—

LETTERS OF CREDIT AND GUARANTEES

As at March 31, 2004, CAE had outstanding letters of credit and performance guarantees in the amount of $207.7 million (2003 — $195.1 million) issued in the normal course of business. These guarantees are issued under standby facilities available to the Company through various financial institutions.

The advance payment guarantees are related to progress/milestone payments made by our customers and are reduced or eliminated upon delivery of the product. The contract performance guarantees are linked to the completion of the intended product or service rendered by CAE and at the satisfaction of the customer. It represents 10% to 20% of the overall contract amount. The customer releases the Company from these guarantees at the signature of a certificate of completion. The operating lease obligation provides credit support for the benefit of the owner participant in the September 30, 2003 sale and leaseback transaction.

(amounts in millions of Canadian dollars)	**2004**	**2003**
Advance payment	**$ 146.4**	$ 159.9
Contract performance	**22.5**	32.4
Operating lease obligation	**31.1**	—
Others	**7.7**	2.8
Total	**$ 207.7**	$ 195.1

RESIDUAL VALUE GUARANTEES — SALE AND LEASEBACK TRANSACTIONS

Following certain sale and leaseback transactions, the Company has agreed to guarantee the residual value of the underlying equipment in the event that the equipment is returned to the lessor and the net proceeds of any eventual sale do not cover the guaranteed amount. The maximum amount of exposure is $52.3 million of which $22.6 million matures in 2007, $12.3 million matures in 2008, $8.2 million in 2020 and $9.2 million in 2023. Of this amount, as at March 31, 2004, $33.1 million is recorded as deferred gain (2003 — $22.6 million).

INDEMNIFICATIONS

In certain instances when CAE sells businesses, the Company may retain certain liabilities for known exposures and provide indemnification to the buyer with respect to future claims for certain unknown liabilities existing, or arising from events occurring, prior to the sale date, including liabilities for taxes, legal matters, environmental exposures, product liability, and other obligations. The terms of the indemnifications vary in duration, from one to two years for certain types of indemnities, terms for tax indemnifications that are generally aligned to the applicable statute of limitations for the jurisdiction in which the divestiture occurred, and terms for environmental liabilities that typically do not expire. The

maximum potential future payments that the Company could be required to make under these indemnifications are either contractually limited to a specified amount or unlimited. The Company believes that the maximum potential future payments that the Company could be required to make under these indemnifications are not determinable at this time, as any future payments would be dependent on the type and extent of the related claims, and all available defences, which are not estimable. However, costs incurred to settle claims related to these indemnifications have not been material to the Company's financial position, results of operations or cash flows.

NOTE 14 — INCOME TAXES

A reconciliation of income taxes at Canadian statutory rates with the reported income taxes is as follows:

(amounts in millions of Canadian dollars)	2004	2003	2002
Earnings before income taxes and discontinued operations	**$ 87.7**	$ 191.2	$ 218.3
Statutory income tax rates in Canada	**32.8%**	34.7%	37.4%
Income taxes at Canadian statutory rates	**$ 28.7**	$ 66.3	$ 81.6
Difference between Canadian statutory rates and those applicable to foreign subsidiaries	**(2.7)**	0.7	5.3
Manufacturing and processing allowance	**(0.5)**	(3.5)	(13.1)
Losses not tax effected	**0.2**	1.0	11.0
Tax benefit of losses not previously recognized	**(5.6)**	(1.1)	(6.7)
Non-taxable capital gain	**(0.2)**	(0.7)	(9.0)
Non-deductible items	**3.3**	(0.4)	1.8
Prior years' tax adjustments and assessments	**(3.6)**	(0.9)	1.1
Impact of change in income tax rates on future income taxes	**0.7**	(1.7)	0.4
Non-taxable research and development tax credits	**(0.6)**	(0.5)	(3.0)
Other	**0.9**	1.0	0.5
Total income tax expense	**$ 20.6**	$ 60.2	$ 69.9

Significant components of the provision for income tax expense attributable to continuing operations are as follows:

(amounts in millions of Canadian dollars)	2004	2003	2002
Current income tax expense	**$ 17.0**	$ 41.4	$ 62.8
Future income tax expense	**3.6**	18.8	7.1
Total income tax expense	**$ 20.6**	$ 60.2	$ 69.9

The tax effects of temporary differences that gave rise to future tax liabilities and assets are as follows:

(amounts in millions of Canadian dollars)	2004	2003
Non-capital loss carryforwards	**$ 76.9**	$ 91.1
Capital loss carryforwards	**0.9**	—
Investment tax credits	**(14.3)**	(18.9)
Property, plant and equipment	**(62.2)**	(56.0)
Employee pension plans	**—**	(2.0)
Amounts not currently deductible	**13.7**	21.1
Percentage of completion versus completed contract	**(45.3)**	(35.2)
Other	**11.6**	(2.8)
	$ (18.7)	$ (2.7)
Valuation allowance	**(26.6)**	(31.0)
Net future income tax liabilities	**$ (45.3)**	$ (33.7)

As of March 31, 2004, the Company has accumulated non-capital losses carried forward relating to operations in the United States for approximately $171.3 million (US$130.7 million). For financial reporting purposes, a net future tax income asset of $38.6 million (US$29.5 million) has been recognized in respect of these loss carryforwards.

The Company has accumulated non-capital tax losses carried forward relating to its operations in other countries of approximately $57.4 million. For financial reporting purposes, a net future income tax asset of $11.7 million has been recognized.

The losses for income tax purposes expire as follows:

(amounts in millions of Canadian dollars)

Year of expiration	United States (US$)	Other Countries (C$)
2005	—	—
2006	16.5	—
2007	44.5	—
2008	27.2	—
2009	6.0	—
2010-2021	36.5	14.5
No expiration	—	42.9
	130.7	57.4

The valuation allowance relates principally to loss carryforward benefits where realization is not likely due to a history of loss carryforwards and to the uncertainty of sufficient taxable earnings in the future, together with time limitations in the tax legislation giving rise to the potential benefit. In 2004, $5.7 million (2003 — $21.1 million) of the valuation allowance balance was reversed when it became more likely than not that benefits would be realized.

NOTE 15 — DEFERRED GAINS AND OTHER LONG-TERM LIABILITIES

(amounts in millions of Canadian dollars)	2004	2003
Deferred gains on sale and leasebacks (i)	**$ 90.5**	$ 75.6
Deferred revenue and gains	**33.9**	33.1
Long-term portion of employee benefits obligation	**10.9**	11.2
Government cost sharing (note 18)	**7.2**	4.6
Other	**13.1**	15.1
	$ 155.6	$ 139.6

i The related amortization for the year amounts to $3.2 million (2003 — $2.1 million).

NOTE 16 — SUPPLEMENTARY CASH FLOW INFORMATION

Cash provided by (used in) non-cash working capital is as follows:

(amounts in millions of Canadian dollars)	2004	2003	2002
Accounts receivable	**$ (21.3)**	$ 22.3	$ (50.4)
Inventories	**(19.0)**	(3.1)	(23.8)
Prepaid expenses	**(6.6)**	(6.0)	1.9
Income taxes recoverable	**4.8**	23.1	36.9
Accounts payable and accrued liabilities	**(56.4)**	13.7	27.9
Deposits on contracts	**(8.7)**	(91.3)	(0.1)
	$ (107.2)	$ (41.3)	$ (7.6)
Interest paid	**$ 41.0**	$ 38.8	$ 25.3
Income taxes paid	**$ 8.3**	$ 3.5	$ 8.2
Amortization of other assets	**$ 13.1**	$ 8.8	$ 3.2

NOTE 17 — CONTINGENCIES

Through the normal course of operations, the Company is party to a number of lawsuits, claims and contingencies. Accruals are made in instances where it is probable that liabilities will be incurred and where such liabilities can be reasonably estimated. Although it is possible that liabilities may be incurred in instances for which no accruals have been made, the Company has no reason to believe that the ultimate outcome of these matters will have a material impact on its financial position.

NOTE 18 — GOVERNMENT COST SHARING

The Company has signed agreements with the Government of Canada whereby the latter shares in the cost, based on expenditures incurred by the Company, of certain research and development programs for visual systems and advanced flight simulation technology for civil applications and networked simulation for military applications. Funding in the amount of $31.2 million related to the visual research and development programs was completed in 2001. Royalty payments for this program are estimated at $0.4 million in fiscal 2004 (2003 — $1.6 million). In fiscal 2002, funding of $41.4 million was approved for advanced civil flight simulation. In fiscal 2003, funding of $39.0 million was also approved to develop a military network simulation. The Company provided for $10.2 million of future repayments on these two programs in fiscal 2004. Funding for these programs is based on expenditures incurred by the Company. The amount of funding received in fiscal 2004 was $5.4 million (2003 — $20.2 million, 2002 — $15.8 million) and is now complete for the civil program and $8.5 million (2003 — $12.3 million, 2002 — nil) for the military program.

These programs are repayable in the form of royalties to March 2013 based on future sales. The maximum amount of royalties payable under the visual program is $41.4 million. The maximum payment under the civil or military simulation programs, based on future sales, is $66.0 million and $53.6 million respectively.

NOTE 19 — OPERATING LEASE COMMITMENTS

Future minimum lease payments under operating leases are as follows:

(amounts in millions of Canadian dollars)	Civil Simulation and Training	Military Simulation and Training	Marine Controls	Total
Years ending March 31,				
2005	$ 53.0	$ 37.8	$ 1.4	$ 92.2
2006	50.6	32.9	1.1	84.6
2007	65.2	24.1	0.2	89.5
2008	52.7	23.6	0.1	76.4
2009	35.5	22.8	0.1	58.4
Thereafter	313.5	100.1	0.1	413.7
	$ 570.5	$ 241.3	$ 3.0	$ 814.8

NOTE 20 — PENSIONS

The Company has two registered defined benefit plans in Canada (one for employees and one for designated executives) that provide benefits based on length of service and final average earnings. In addition, the Company maintains a supplemental arrangement to provide defined benefits for designated executives. This supplemental arrangement is solely the obligation of the Company and there is no requirement to fund it. The Company, however, is obligated to pay the benefits when they become due. Once the designated executive retires from the Company, the Company is required to secure the obligation for that executive. As at March 31, 2004, the Company has issued letters of credit totalling $11.9 million to secure the obligations under the Supplementary Plan.

Contributions reflect actuarial assumptions concerning future investment returns, salary projections and future service benefits. Plan assets are represented primarily by Canadian and foreign equities and government and corporate bonds.

The changes in the registered pension obligations and in the fair value of assets and the funded status of the registered defined benefit plans were as follows:

(amounts in millions of Canadian dollars)	2004	2003
Change in pension obligations		
Pension obligation, beginning of year	**$ 133.5**	$ 117.1
Current service cost	**3.4**	3.8
Interest cost	**8.6**	7.6
Settlement of discontinued operations	**(1.5)**	—
Employee contributions	**2.7**	2.7
Loss on plan amendments	**1.2**	2.8
Pension benefits paid	**(8.4)**	(7.8)
Actuarial loss	**—**	7.3
Pension obligation, end of year	**$ 139.5**	$ 133.5
Change in fair value of plan assets		
Fair value of plan assets, beginning of year	**$ 105.6**	$ 111.7
Actual return on plan assets	**14.4**	(7.3)
Pension benefits paid	**(8.4)**	(7.8)
Settlement of discontinued operations	**(1.3)**	—
Plan expenses	**(0.3)**	(0.3)
Employee contributions	**2.7**	2.7
Employer contributions	**6.2**	6.6
Fair value of plan assets, end of year	**$ 118.9**	$ 105.6
Funded status-plan deficit	**$ (20.6)**	$ (27.9)
Unrecognized net actuarial loss	**34.4**	45.0
Unamortized past service cost	**5.8**	5.2
Accrued net pension asset, end of year	**$ 19.6**	$ 22.3

The actuarial present value of accrued pension benefits has been estimated taking into consideration economic and demographic factors over an extended future period. Significant assumptions used in the calculation are as follows:

	2004	2003
Return on plan assets	**6.5%**	6.5%[1]
Discount rate for pension benefit obligations	**6.5%**	6.5%
Compensation rate increase	**2.75% to 5.25%**	2.75% to 5.25%

1 Return on plan asset assumptions was changed from 9.0% to 6.5% during the second half of fiscal 2003.

The Company measures its benefit obligations and fair value of plan assets for accounting purposes as at December 31 of each year. The most recent actuarial valuation of the pension plans for funding purposes was as of December 31, 2001 for the employee registered plan, and March 28, 2002 for the designated executive registered plan. As at those dates, the combined pension plans have an excess of pension obligations over plan assets. The next required valuation will be as of December 31, 2004 for the employee registered plan and March 28, 2005 for the designated executive registered plan.

The registered net pension expense for the years ended March 31 included the following components:

(amounts in millions of Canadian dollars)	2004	2003	2002
Current service cost	**$ 3.4**	$ 3.8	$ 3.5
Plan expenses	**0.3**	0.3	—
Interest cost on projected pension obligations	**8.5**	7.6	7.2
Expected return on plan assets	**(6.7)**	(7.2)	(10.6)
Amortization of net actuarial loss	**2.2**	0.8	—
Amortization of past service costs	**0.4**	0.2	0.1
Net pension expense	**$ 8.1**	$ 5.5	$ 0.2
Net pension expense	**$ 8.1**	$ 5.5	$ 0.2
Settlement and other loss	**0.8**	—	—
Net pension expense including settlement and other loss	**$ 8.9**	$ 5.5	$ 0.2

With respect to the supplemental arrangement, the net pension expense for 2004 was $1.7 million (2003 — $1.7 million; 2002 — $1.6 million). The net pension expense for 2004 is made up of $0.8 million of current service cost (2003 — $0.8 million; 2002 — $0.7 million) and $0.9 million of interest cost on projected obligations (2003 — $0.9 million; 2002 — $0.9 million).

The pension obligations relative to the supplemental arrangement were $14.6 million as at March 31, 2004 (2003 — $13.7 million; 2002 — $14.3 million). In fiscal 2003, the current service cost was $0.8 million, the interest cost on projected pension obligations was $0.9 million and the benefits paid were $0.9 million. In fiscal 2002, the current service cost was $0.8 million, the interest cost on projected pension obligations was $0.9 million and the benefits paid were $0.6 million. The total obligation for the Company, included in Long-Term Liabilities, as at March 31, 2004 was $15.4 million (2003 — $14.6 million). The difference between this obligation recognized by the Company and the pension obligation is the amount of unamortized actuarial gains of $0.8 million (2003 — $0.9 million).

NOTE 21 — CURRENCY TRANSLATION ADJUSTMENT

The change in the currency translation adjustment account included in shareholders' equity resulted from the translation to Canadian dollars of assets and liabilities of the Company's self-sustaining foreign operations, exchange gains or losses on inter-company account balances that form part of the net investments and foreign exchange gains or losses on long-term debt designated as hedges of the net investment in self-sustaining foreign operations.

The net change in this account is as follows:

(amounts in millions of Canadian dollars)	2004	2003
Balance at beginning of year	**$ 28.5**	$ (15.1)
Effect of changes in exchange rates during the year:		
On net investment in self-sustaining subsidiaries	**(62.2)**	21.0
On certain long-term debt denominated in foreign currencies designated as a hedge of net investments in self-sustaining foreign subsidiaries	**21.6**	22.6
Balance at end of year	**$ (12.1)**	$ 28.5

NOTE 22 — OPERATING SEGMENTS AND GEOGRAPHIC INFORMATION

The Company's significant operating segments include:

(i) Civil Simulation and Training — a world-leading supplier of civil flight simulators and visual systems, and a provider of business and civil aviation training.

(ii) Military Simulation and Training — a premier supplier of military flight and land-based simulators, visual and training systems.

(iii) Marine Controls — a world leader in the supply of automation and control systems for the naval and commercial markets. The business also provides naval training systems and designs and manufactures power plant training simulators and systems.

Each operating segment is led by a senior executive and offers different products and uses different technology and marketing strategies. The Company evaluates performance based on earnings before interest, income taxes and discontinued operations and uses capital employed to assess resources allocated to each segment. Capital employed includes accounts receivable, inventories, prepaid expenses, restricted cash, property, plant and equipment, goodwill, intangible assets and other assets less accounts payable and accrued liabilities, deposits on contracts and deferred gains and other long-term liabilities.

Prior to fiscal 2003, the Marine Controls segment was aggregated and presented with the Military Simulation and Training segment. In 2003, these segments were presented separately and accordingly comparative figures for fiscal 2002 have been restated in order to be consistent with the new basis of presentation.

Financial information on the Company's operating segments is shown in the following table:

OPERATING SEGMENTS

(amounts in millions of Canadian dollars)	2004	2003	2002
Capital employed			
Civil Simulation and Training	**$ 1,041.8**	$ 1,156.9	$ 1,057.3
Military Simulation and Training	**301.8**	247.7	187.3
Marine Controls	**160.0**	122.9	86.0
Other	**(23.5)**	(9.7)	11.8
Total capital employed	**$ 1,480.1**	$ 1,517.8	$ 1,342.4
Cash and cash equivalents	**61.9**	17.1	88.8
Restricted cash	**7.0**	—	—
Short-term investments	**—**	2.6	21.3
Income taxes recoverable	**52.0**	25.7	15.8
Accounts payable and accrued liabilities	**350.0**	413.3	420.5
Deposits on contracts	**91.1**	101.2	189.1
Future income taxes — short-term	**1.8**	3.5	28.9
Future income taxes — long-term	**93.8**	85.7	74.1
Deferred gains and other long-term liabilities	**155.6**	139.6	73.7
Assets of discontinued operations	**—**	50.0	123.8
Total assets	**$ 2,293.3**	$ 2,356.5	$ 2,378.4
Total assets by segment			
Civil Simulation and Training	**$ 1,327.3**	$ 1,474.3	$ 1,380.9
Military Simulation and Training	**503.6**	442.6	444.6
Marine Controls	**219.4**	214.8	165.1
Assets of discontinued operations	**—**	50.0	123.8
Other	**243.0**	174.8	264.0
	$ 2,293.3	$ 2,356.5	$ 2,378.4
Additions and adjustments to goodwill			
Civil Simulation and Training	**$ (12.5)**	$ (4.9)	$ 217.8
Military Simulation and Training	**(7.4)**	(7.1)	96.1
Marine Controls	**(3.1)**	3.3	43.1
	$ (23.0)	$ (8.7)	$ 357.0
Additions and adjustments to intangible assets			
Civil Simulation and Training	**$ (6.0)**	$ 6.1	$ 144.2
Military Simulation and Training	**(0.2)**	(0.2)	2.5
Marine Controls	**(1.5)**	12.1	19.7
	$ (7.7)	$ 18.0	$ 166.4
Capital expenditures			
Civil Simulation and Training	**$ 83.5**	$ 207.0	$ 216.7
Military Simulation and Training	**5.1**	12.1	14.1
Marine Controls	**5.9**	19.8	18.8
	$ 94.5	$ 238.9	$ 249.6
Amortization of property, plant and equipment			
Civil Simulation and Training	**$ 38.3**	$ 37.8	$ 24.4
Military Simulation and Training	**12.7**	11.0	10.9
Marine Controls	**1.6**	3.0	1.6
Other	**0.9**	0.3	0.1
	$ 53.5	$ 52.1	$ 37.0

OPERATING SEGMENTS

(amounts in millions of Canadian dollars)	2004	2003	2002
Amortization of intangible assets			
Civil Simulation and Training	**$ 6.8**	$ 7.5	$ 2.7
Military Simulation and Training	**0.1**	0.2	—
Marine Controls	**1.9**	2.0	0.3
	$ 8.8	$ 9.7	$ 3.0
Amortization of other assets			
Civil Simulation and Training	**$ 10.1**	$ 5.3	$ 2.5
Military Simulation and Training	**1.4**	1.6	0.6
Other	**1.6**	1.9	—
	$ 13.1	$ 8.8	$ 3.1

GEOGRAPHIC INFORMATION

(amounts in millions of Canadian dollars)	2004	2003	2002
Revenue from external customers based on their location			
Canada	**$ 128.5**	$ 89.0	$ 102.7
United States	**338.2**	329.5	347.0
United Kingdom	**110.6**	149.7	127.4
Germany	**137.5**	119.1	91.2
Other European countries	**177.6**	156.2	173.8
Other countries	**200.8**	287.0	284.4
	$ 1,093.2	$ 1,130.5	$ 1,126.5
Property, plant and equipment, goodwill and intangible assets			
Canada	**$ 224.8**	$ 226.1	$ 126.6
United States	**443.1**	577.6	579.0
Europe	**619.8**	582.0	520.6
Other countries	**54.3**	83.2	151.2
	$ 1,342.0	$ 1,468.9	$ 1,377.4

NOTE 23 — RESTRUCTURING COSTS

On April 5, 2004, the Company announced employee layoffs, of which 85% were based in Montreal. A restructuring charge of $8.2 million, related to these employees, to cover severance and other costs has been recorded in the results of the fourth quarter of fiscal year 2004, in accordance with the CICA's EIC-134, *Accounting for Severance and Termination Benefits*.

The $8.2 million liability is included in the Company's balance sheet under the accounts payable and accrued liabilities line. This liability is expected to be fully used during the first quarter of fiscal year 2005. Earlier during the fourth quarter of fiscal year 2004, the Company incurred $1.8 million in severance costs for Montreal-based employees. The total restructuring costs incurred during the fourth quarter of fiscal year 2004 amount to $10.0 million.

NOTE 24 — DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP), which differ in certain respects from those principles that the Company would have followed had its financial statements been prepared in accordance with accounting principles generally accepted in the United States (US GAAP).

Additional disclosures required under US GAAP have been provided in the accompanying financial statements and notes.

The reconciliation of net earnings in accordance with Canadian GAAP to conform to US GAAP is as follows:

Years ended March 31 (amounts in millions of Canadian dollars, except per share amounts)	2004	2003	2002
Earnings from continuing operations for the year in accordance with Canadian GAAP	**$ 67.1**	$ 131.0	$ 148.4
Deferred development costs, net of tax recovery of $1.2 (2003 — $2.7), (2002 — $5.0) (A)	**(2.5)**	(5.8)	(10.6)
Deferred pre-operating costs, net of tax expense of $0.3 (2003 — $0.4), (2002 — $4.1) (B)	**(0.2)**	(0.8)	(8.8)
Derivative instruments, net of tax recovery of $4.3 (2003 — $7.7) (2002 — $0.2) (D)	**(9.1)**	(16.7)	(0.5)
Leases net of tax expense of $2.5 (2003 — $0.9), (2002 — tax recovery $0.8) (H)	**5.3**	2.0	(1.8)
Foreign exchange gain on purchase of subsidiary in 2002, net of tax of $3.7 (F)	**—**	—	7.9
Earnings from continuing operations before cumulative effect of accounting change — US GAAP	**60.6**	109.7	134.6
Discontinued operations	**(3.1)**	(13.8)	1.1
Net earnings before cumulative effect of accounting change — US GAAP	**57.5**	95.9	135.7
Cumulative effect on prior years of accounting change (D) (E)	**—**	—	5.3
Net earnings for the year in accordance with US GAAP	**$ 57.5**	$ 95.9	$ 141.0
Basic and diluted earnings per share from continuing operations in accordance with US GAAP	**0.26**	0.50	0.62
Basic and diluted results per share from discontinued operations in accordance with US GAAP	**(0.02)**	(0.07)	0.01
Basic and diluted net earnings per share before cumulative effect of accounting change in accordance with US GAAP	**0.24**	0.43	0.63
Basic and diluted net earnings per share in accordance with US GAAP	**0.24**	0.43	0.65
Dividends per common share	**0.12**	0.12	0.11
Weighted average number of common shares outstanding	**233.2**	219.4	217.6

Comprehensive income

(amounts in millions of Canadian dollars)	2004	2003	2002
Net earnings in accordance with US GAAP	**$ 57.5**	$ 95.9	$ 141.0
Accumulated minimum pension liability, net of taxes of $4.2 (2003 — $10.8)	**9.1**	(23.5)	—
Foreign currency translation adjustments	**(40.1)**	36.8	(1.5)
Comprehensive income	**$ 26.5**	$ 109.2	$ 139.5

Accumulated Other Comprehensive Loss in accordance with US GAAP

(amounts in millions of Canadian dollars)	2004	2003	2002[1]
Beginning balance	**$ (1.8)**	$ (15.1)	$ (13.6)
Currency translation adjustments	**(40.1)**	36.8	(1.5)
Change in minimum pension liability	**9.1**	(23.5)	—
Ending balance	**$ (32.8)**	$ (1.8)	$ (15.1)

1 The beginning balance of 2002 is composed only of currency translation adjustments.

The cumulative effect of these adjustments on the shareholders' equity of the Company is as follows:

(amounts in millions of Canadian dollars)	2004	2003
Shareholders' equity in accordance with Canadian GAAP	**$ 918.8**	$ 750.2
Deferred development costs, net of tax of $13.4 (2003 — $12.2), (2002 — $9.5) (A)	**(27.9)**	(25.4)
Deferred pre-operating costs, net of tax of $8.8 (2003 — $9.1), (2002 — $8.7) (B)	**(18.9)**	(18.7)
Derivative instruments, net of tax expense of $9.8 (2003 — tax expense $5.5), (2002 — tax recovery $2.2) (D)	**(21.0)**	(11.9)
Foreign currency translation adjustments (I)	**(6.6)**	(6.6)
Leases, net of tax recovery of $3.0 (2003 — tax recovery $0.5), (2002 — tax expense $0.4) (H)	**6.0**	0.7
Foreign exchange gain on purchase of subsidiary, net of tax of $3.7 (2003 — $3.7), (2002 — $3.7) (F)	**7.9**	7.9
Minimum pension liability, net of tax of $6.6 (2003 — $10.8), (2002 — nil) (J)	**(14.4)**	(23.5)
Shareholders' equity in accordance with US GAAP	**$ 843.9**	$ 672.7

The balance sheets in accordance with US GAAP as at March 31, 2004 and March 31, 2003 are as follows:

as at March 31 (amounts in millions of Canadian dollars)	Notes	March 31, 2004 Canadian GAAP	March 31, 2004 US GAAP	March 31, 2003 Canadian GAAP	March 31, 2003 US GAAP
Assets					
Cash and cash equivalents		**$ 61.9**	**$ 61.9**	$ 17.1	$ 17.1
Short-term investments	C	**—**	**—**	2.6	2.6
Accounts receivable		**390.9**	**390.9**	373.1	373.1
Derivative instruments	D	**—**	**1.6**	—	2.7
Inventories		**154.8**	**154.8**	136.3	136.3
Prepaid expenses	H	**20.7**	**17.3**	14.0	9.6
Income taxes recoverable		**52.0**	**52.0**	25.7	25.7
Future income taxes		**1.8**	**1.8**	3.5	3.5
		$ 682.1	**$ 680.3**	$ 572.3	$ 570.6
Restricted cash		**7.0**	**7.0**	14.4	14.4
Assets of discontinued operations		**—**	**—**	50.0	50.0
Property, plant and equipment, net	H	**843.0**	**921.9**	930.4	1,018.9
Future income taxes	A,B,D,F,H,J	**93.8**	**125.5**	85.7	119.1
Intangible assets	J	**155.2**	**161.0**	171.7	176.9
Goodwill	F	**343.8**	**355.4**	366.8	378.4
Other assets	A,B	**168.4**	**99.3**	165.2	99.9
		$ 2,293.3	**$ 2,350.4**	$ 2,356.5	$ 2,428.2
Liabilities and shareholders' equity					
Current liabilities					
Accounts payable and accrued liabilities	H	**$ 350.0**	**$ 349.2**	$ 413.3	$ 411.0
Deposits on contracts		**91.1**	**91.1**	101.2	101.2
Derivative instruments	D	**—**	**32.7**	—	20.4
Long-term debt due within one year	H	**13.5**	**25.8**	13.4	30.0
Future income taxes		**51.1**	**51.1**	42.4	42.4
		$ 505.7	**$ 549.9**	$ 570.3	$ 605.0
Liabilities of discontinued operations		**$ —**	**$ —**	$ 17.9	17.9
Long-term debt	H	**623.4**	**717.0**	798.0	900.6
Deferred gains and other long-term liabilities	H,J	**155.6**	**149.8**	139.6	151.5
Future income taxes		**89.8**	**89.8**	80.5	80.5
		$ 1,374.5	**$ 1,506.5**	$ 1,606.3	$ 1,755.5
Shareholders' equity					
Capital stock	G,K	**$ 367.5**	**$ 611.7**	$ 190.5	$ 439.8
Contributed surplus		**1.3**	**1.3**		
Retained earnings	A,B,D,E,F,G,H,K	**562.1**	**263.7**	531.2	234.7
Currency translation adjustment		**(12.1)**	**—**	28.5	—
Accumulated other comprehensive loss	C,H,J	**—**	**(32.8)**	—	(1.8)
		$ 918.8	**$ 843.9**	$ 750.2	$ 672.7
		$ 2,293.3	**$ 2,350.4**	$ 2,356.5	$ 2,428.2

RECONCILIATION ITEMS

A) Deferred development costs

Under US GAAP, development costs are charged to expense in the period incurred. Under Canadian GAAP, certain development costs are capitalized and amortized over their estimated useful lives if they meet the criteria for deferral. The difference between US GAAP and Canadian GAAP represents the gross development costs capitalized in the respective year, net of the reversal of amortization expense recorded for Canadian GAAP relating to amounts previously capitalized.

B) Deferred pre-operating costs

Under US GAAP, pre-operating costs are charged to expense in the period incurred. Under Canadian GAAP, the amounts are deferred and amortized over five to 20 years based on the expected period and pattern of benefit of the deferred expenditures. The difference between US GAAP and Canadian GAAP represents the gross pre-operating costs capitalized in the respective year, net of the reversal of amortization expense recorded for Canadian GAAP relating to amounts previously capitalized.

C) Portfolio investments

Under Canadian GAAP, portfolio investments (short-term investments) are accounted for at the least of cost and market value. Under US GAAP, portfolio investments are classified as held to maturity and thus are recorded at amortized cost. There is no material difference for US GAAP purposes. The investments held at March 31, 2003 had maturity dates of within one month of March 31, 2003.

D) Derivative financial instruments

Under Canadian GAAP, the nature and fair values of derivative financial instruments, all of which are entered into for hedging purposes, are disclosed. The Company recognizes the gains and losses on forward contracts in income concurrently with the recognition of the transactions being hedged. The interest payments relating to swap contracts are recorded in net earnings over the life of the underlying transaction on an accrual basis as an adjustment to interest income or interest expense. Under US GAAP, all derivatives are recorded on the balance sheet at fair value. Realized and unrealized gains and losses resulting from the valuation of derivatives (including embedded derivatives in purchase and sale contracts) at market value are recognized (against interest expense for interest rate swap and against revenues or cost of goods sold for the foreign exchange contracts) as the gains and losses arise and not concurrently with the recognition of the transactions being hedged, as the Company does not apply the optional hedge accounting provisions of SFAS 133 and 138.

Upon the initial adoption of SFAS 133 and 138 on April 1, 2001, the cumulative effect of the accounting change resulted in an increase in net earnings of $5.3 million net of taxes of $2.4 million.

E) Adjustments for changes in accounting policies

Under US GAAP, the cumulative effect of certain accounting changes must be included in earnings in the year of the change. Under Canadian GAAP, the impact is reflected through retained earnings.

F) Foreign exchange gain on purchase of subsidiary

Under Canadian GAAP, upon the purchase of Schreiner, a foreign exchange gain was recorded in fiscal 2002 as a reduction of goodwill on the forward contract hedge of the foreign currency denominated purchase price. Under US GAAP, this gain was recorded in earnings.

G) Reduction in stated capital

On July 7, 1994, the Company applied a portion of its deficit as a reduction of its stated capital in the amount of $249.3 million. Under US GAAP, the reduction of stated capital would not be permitted.

H) Leases

Under Canadian GAAP, certain of the Company's leases of simulators, with aggregate minimum future lease payments of $133.5 million are accounted for as operating leases.

Under these agreements, the lessors hold the simulators under lease and have arranged financing through Special Purposes Entities (SPEs). Under US GAAP, since the legal stated capital of these (SPEs) represent less than 3% of the assets of those (SPEs), the assets, liabilities, results of operations and cash flows of the SPE must be consolidated into those of the Company. Amortization expense related to these leases amounts to $3.8 million in 2004 (2003 — $4.4 million, 2002 — $2.0 million) and interest expense related to the financing arrangement amounts to $7.6 million in 2004 (2003 — $8.3 million, 2002 — $6.0 million). Currency translation adjustments resulting from the consolidation of a foreign SPE considered self-sustaining amount to $0.5 million in 2004 (2003 — $6.6 million).

I) Comprehensive income

US GAAP requires disclosure of comprehensive income, which comprises income and other components of comprehensive income. Other comprehensive income includes items that cause changes in shareholders' equity but are not related to share capital or net earnings which, for the Company, comprises currency translation adjustments and change in minimum pension liability. Under Canadian GAAP, there is no requirement to report comprehensive income.

J) Minimum pension liability

Under US GAAP, if the accumulated benefit obligation exceeds the market value of plan assets, a minimum pension liability for the excess is recognized to the extent that the liability recorded in the balance sheet is less than the minimum liability. Any portion of the additional liability that relates to unrecognized past service costs is recognized as an intangible asset while the remainder is charged to comprehensive income. The concept of additional minimum liability does not exist under Canadian GAAP.

K) Share issue costs

Under Canadian GAAP, costs related to share issuance can be presented in retained earnings, net of taxes. Under US GAAP, these costs were recorded as a reduction of capital stock.

CONSOLIDATED STATEMENT OF CASH FLOWS

Under US GAAP reporting, separate subtotals within operating, financing and investment activities would not be presented.

The reconciliation of cash flows under Canadian GAAP to conform to US GAAP is as follows:

Years ended March 31 (amounts in millions of Canadian dollars)	Note	2004	2003	2002
Cash flows from operating activities in accordance with Canadian GAAP		**$ 5.7**	$ 154.9	$ 157.2
Deferred development costs	A	**(12.7)**	(13.3)	(30.1)
Deferred pre-operating costs	B	**(10.4)**	(10.7)	(13.4)
Foreign exchange gain on purchase of a subsidiary	F	**—**	—	11.6
Leases	H	**13.7**	10.9	3.8
Cash flows from operating activities in accordance with US GAAP		**$ (3.7)**	$ 141.8	$ 129.1
Cash flows from investing activities in accordance with Canadian GAAP		**$ 24.5**	$ (134.4)	$ (759.9)
Deferred development costs	A	**12.7**	13.3	30.1
Deferred pre-operating costs	B	**10.4**	10.7	13.4
Foreign exchange gain on purchase of a subsidiary	F	**—**	—	(11.6)
Cash flows from investing activities in accordance with US GAAP		**$ 47.6**	$ (110.4)	$ (728.0)
Cash flows from financing activities in accordance with Canadian GAAP		**$ 17.8**	$ (94.4)	$ 535.3
Leases	H	**(13.7)**	(10.9)	(3.8)
Cash flows from financing activities in accordance with US GAAP		**$ 4.1**	$ (105.3)	$ 531.5

RECENTLY ADOPTED ACCOUNTING STANDARDS

Accounting for stock-based compensation

In fiscal 2004, compensation costs of $1.3 million were recorded in net earnings with a corresponding credit to contributed surplus using the fair value method of accounting for awards that were granted in May 2003.

Prior to April 1, 2003, CAE had elected to measure stock-based compensation using the intrinsic value base method of accounting. In that instance, however, under SFAS 123, the Company is required to make pro forma disclosures of net earnings, basic earnings per share and diluted earnings per share using the fair value method of accounting for stock-based compensation granted prior to April 1, 2003.

Accordingly, CAE's net earnings, basic earnings per share and diluted earnings per share for the year ended March 31, 2004 would have been reduced on a pro forma basis by $4.7 million, or $0.02 per common share for basic and diluted earnings respectively (for the year ended March 31, 2003 — $5.6 million, or $0.03 per common share for basic and diluted earnings respectively; for the year ended March 31, 2002 — $3.7 million, or $0.02 per common share for basic and diluted earnings respectively) for stock-based compensation granted prior to April 1, 2003.

Pro forma net earnings and pro forma basic and diluted net earnings per share are presented below:

(amounts in millions of Canadian dollars, except per share amounts)	2004	2003	2002
Net earnings, as reported per US GAAP	**$ 57.5**	$ 95.9	$ 141.0
Pro forma impact	**(4.7)**	(5.6)	(3.7)
Pro forma net earnings	**52.8**	90.3	137.3
Pro forma basic and diluted net earnings per share	**0.23**	0.41	0.62

The fair value of the options granted during the years ended March 31, 2004, 2003 and 2002 are estimated at $1.65 per share, $5.84 per share and $4.87 per share respectively.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

Years ended March 31	2004	2003	2002
Expected option life (years)	**6**	6	6
Expected volatility	**41.5%**	46.5%	36.3%
Risk-free interest rate	**5.75%**	5.26%	5.17%
Dividend Yield	**1.290%**	1.058%	1.040%

Disclosure of guarantees

In fiscal 2002, the Company adopted the FASB issued interpretation (FIN) No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, which requires companies that act as guarantors to disclose more information in their financial statements about their obligations under certain guarantees. It defines a guarantee and also requires guarantors to recognize a liability for the fair value, for guarantees given on or after January 1, 2003, of their obligation when they enter into these guarantees. The disclosure requirements of FIN No. 45 apply to financial statements issued after December 15, 2002. Similar accounting recommendations in

Canada require disclosure of guarantees but do not require liability recognition.

Derivative instruments and hedging activities

In fiscal 2004, the Company adopted SFAS 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* . SFAS 149 amends and clarifies the financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS 133. SFAS 149 had no impact on CAE's financial position as at March 31, 2004.

Consolidation of variable interest entities

In January 2003, the FASB issued FIN No. 46, *Consolidation of Variable Interest Entities*. This interpretation clarified how to apply Accounting Research Bulletin No. 51, *Consolidated Financial Statements to those entities defined as "Variable Interest Entities",* when equity investors are not considered to have a controlling financial interest or they have not invested enough equity to allow the entity to finance its activities without additional subordinated financial support from other parties.

This interpretation requires that existing unconsolidated variable interest entities be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. An entity that holds a significant variable interest but is not the primary beneficiary is subject to specific disclosure requirements.

In December 2003, the FASB issued FIN No. 46R, which modifies the scope exceptions provided in FIN No. 46. The Company is required to replace FIN No. 46 provisions with FIN No. 46R provisions to all newly created post-January 31, 2003 entities as of the end of the first period ending after March 15, 2005. As a foreign private issuer, the company will apply the provisions of FIN 46R to entities created before February 1, 2003, starting April 1, 2004.

Costs relating to exits and disposals

On April 1, 2003, the Company adopted SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities,* which requires that a liability for a cost associated with an exit or disposal activity be recognized and measured initially at fair value only when a liability is incurred. Similar accounting recommendations under Canadian GAAP have been adopted for exit and disposal activities after April 1, 2003 (note 1).

Pension and other retirement benefits

During 2003, the Financial Accounting Standards Board revised SFAS 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits.* The revised SFAS 132 retains and revises the disclosure requirements contained in the original SFAS 132. It also requires additional disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other postretirement benefit plans.

CAE adopted revised SFAS 132, as it is required for fiscal year ending after December 15, 2003.

ADDITIONAL DISCLOSURES

Additional disclosures required under US GAAP are as follows:

i) Statements of earnings

For the years ended March 31 (amounts in millions of Canadian dollars)	2004 Canadian GAAP	2004 US GAAP	2003 Canadian GAAP	2003 US GAAP	2002 Canadian GAAP	2002 US GAAP
Revenues from sales of simulators and controls systems	**$ 610.9**	**$ 588.5**	$ 684.3	$ 668.1	$ 842.5	$ 846.6
Revenues from sales of services	**$ 482.3**	**$ 482.3**	$ 446.2	$ 446.2	$ 284.0	$ 284.0
Cost of sales from simulators and controls systems	**$ 386.2**	**$ 385.0**	$ 338.2	$ 338.2	$ 465.3	$ 470.3
Cost of sales from services	**$ 277.6**	**$ 269.1**	$ 240.1	$ 244.2	$ 167.9	$ 169.5
Research and development expenses	**$ 81.0**	**$ 84.6**	$ 108.3	$ 116.8	$ 74.6	$ 90.2
Rental expenses	**$ 92.5**	**$ 79.7**	$ 88.1	$ 73.9	$ 52.0	$ 43.6
Selling, general and administrative expenses	**$ 134.4**	**$ 134.4**	$ 134.2	$ 134.2	$ 125.6	$ 125.9
Restructuring costs	**$ 10.0**	**$ 10.0**	$ —	$ —	$ —	$ —
Interest expense	**$ 23.9**	**$ 23.6**	$ 30.4	$ 46.8	$ 22.7	$ 33.5

ii) Balance sheet

Accounts payable and accrued liabilities as per Canadian GAAP are presented below:

As at March 31 (amounts in millions of Canadian dollars)	2004	2003
Accounts payable trade	**$ 103.8**	$ 141.9
Contract liabilities	**$ 101.9**	$ 102.7
Income tax payable	**$ 23.9**	$ 26.4
Other accrued liabilities	**$ 120.4**	$ 142.3
Accounts payable and accrued liabilities	**$ 350.0**	$ 413.3

Accounts receivable from government amounted to $34.9 million as of March 31, 2004 (2003 — $35.4 million).

iii) Income taxes

The components of earnings from continuing operations and income taxes on a Canadian GAAP basis are as follows:

For the years ended March 31 (amounts in millions of Canadian dollars)	2004	2003	2002
Earnings before income taxes and other items			
Canada	**$ 6.3**	**$ 114.0**	$ 179.0
Other countries	**81.4**	**77.2**	39.3
	$ 87.7	**$ 191.2**	$ 218.3
Current income taxes			
Canada	**$ 4.5**	**$ 43.0**	$ 59.3
Other countries	**12.6**	**(1.6)**	3.5
	$ 17.1	**$ 41.4**	$ 62.8
Future income taxes			
Canada	**$ (3.3)**	**$ (1.1)**	$ (2.0)
Other countries	**6.8**	**19.9**	9.1
	$ 3.5	**$ 18.8**	$ 7.1
Income tax provision	**$ 20.6**	**$ 60.2**	$ 69.9

iv) Business combinations

The following unaudited pro forma information for the fiscal years ended March 31, 2003 and 2002 presents a summary of the pro forma consolidated statement of earnings for the Company as if business acquisitions performed during their respective fiscal year referred to in note 2 had occurred on April 1 of the preceding fiscal year. This pro forma information is based on available information and includes certain assumptions and adjustments, which the management of CAE believes to be reasonable. The pro forma information does not give effect to any cost savings or synergies that CAE may enjoy as a result of these acquisitions. Accordingly, the pro forma information is not necessarily indicative of the results that might have been achieved, if the transactions reflected therein had been effective as at the beginning of the period presented, or of the results which may be obtained in the future. This pro forma financial information has been prepared for comparative purposes only and is measured in accordance with Canadian GAAP.

Pro forma

Years ended March 31 (amounts in millions of Canadian dollars, except per share amounts)	2003	2002
	(Unaudited)	(Unaudited)
Revenue		
Civil Simulation and Training	$ 517.2	$ 618.6
Military Simulation and Training	445.7	461.8
Marine Controls	175.8	132.0
	$ 1,138.7	$ 1,212.4
Earnings before interest, income taxes and discontinued operations		
Civil Simulation and Training	$ 116.2	$ 148.3
Military Simulation and Training	73.6	65.6
Marine Controls	31.9	25.4
Earnings before interest, income taxes and discontinued operations	221.7	239.3
Interest expense, net	31.4	44.6
Earnings before income taxes and discontinued operations	190.3	194.7
Income taxes	60.2	61.0
Earnings from continuing operations	$ 130.1	$ 133.7
Results of discontinued operations (note 3)	(13.8)	1.1
Net earnings	$ 116.3	$ 134.8
Earnings and diluted earnings per share from continuing operations	$ 0.59	$ 0.61
Net earnings and diluted net earnings per share	$ 0.53	$ 0.62

Average number of shares outstanding	219.4	218.2

v) Product warranty costs

The Company has warranty obligations in connection to the sale of its civil and military simulators and marine systems. The original warranty period is usually for a two-year period. The cost incurred to provide for these warranty obligations are estimated and recorded as an accrued liability at the time revenue is recognized. The Company estimates its warranty cost for a given product based on past experience. The changes in the Company's accrued warranty liability as at March 31 are as follows:

(amounts in millions of Canadian dollars)	**2004**	**2003**
Accrued warranty liability at beginning of year	**$ 11.5**	$ 12.4
Warranty settlements during the year	**(8.6)**	(7.2)
Warranty provisions	**4.4**	2.5
Adjustments for changes in estimates	**0.4**	3.8
Accrued warranty obligations at the end of the year	**$ 7.7**	$ 11.5

vi) Variable interest entity

In the second quarter of Fiscal 2003, CAE entered into an agreement with a Trust company which was funded by other arms-length third parties to conclude a sale and leaseback transaction of five simulators. This Trust constitutes a Variable Interest Entity.

The net value of this transaction was approximately US$70.0 million. The activities of this Trust company are to lease the five simulators to CAE and collect on a quarterly basis the lease payments for remittance to the owner participant and the lenders.

CAE's maximum exposure of loss as a result of its involvement with the Trust company is limited to US$14.0 million.

vii) Pension

Obligations and funded status:

The accumulated benefit obligation (ABO) for all defined benefit pension plans was $139.8 million for March 31, 2004 and $133.5 million for March 31, 2003. At these dates, all plans had accumulated benefit obligation in excess of plan assets.

Assumptions:

Weighted-average assumptions used to determine net periodic benefit cost for years ended March 31 are described below:

	2004	2003
Expected return on plan assets	**6.5%**	6.5%
Discount rate	**6.5%**	6.5%
Compensation rate increase	**4.5%**	4.5%

For the purpose of calculating the expected return on plan assets, historical and expected future returns were considered separately for each class of asset based on the asset allocation. Also, in light of the investment policies and strategies, an additional percentage was added to the expected return of equities to reflect the added value of the investment manager.

Plan assets:

CAE pension plan weighted-average asset allocations by asset category are as follows:

	Plan Assets at Measurement Dates	
Asset Category	December 31, 2003	December 31, 2002
Equity securities	64%	64%
Debt securities	36%	36%
Real estate	— %	— %
Other	— %	— %
Total	100%	100%

There is a target allocation percentage for equity securities of 64%, which includes a mix of Canadian, US and international equities, and for the debt securities of 36%, which must be rated BBB or higher. Individual asset classes are allowed to fluctuate slightly, and are rebalanced regularly to the target mix. Fund managers are responsible for investing the assets so as to achieve return appropriate to its mandate.

Contributions:

In the next fiscal year, CAE expects to contribute $6.4 million to its registered pension plans and an additional $0.8 million to the Supplementary Plan.

NOTE 25 — COMPARATIVE FINANCIAL STATEMENTS

Certain comparative figures for 2003 and before have been reclassified to conform to the presentation adopted in 2004.

FIVE-YEAR REVIEW

(unaudited) (amounts in millions of dollars except where indicated by *)	2004	2003	2002	2001	2000
Continuing operations					
Revenue	**$ 1,093.2**	1,130.5	1,126.5	891.4	865.1
Amortization	**$ 75.4**	70.6	43.1	19.1	22.3
Earnings	**$ 67.1**	131.0	148.4	103.7	63.0
Earnings per share*	**$ 0.29**	0.60	0.68	0.48	0.29
Net earnings	**$ 64.0**	117.2	149.5	106.1	99.5
Basic and diluted net earnings per share*	**$ 0.27**	0.53	0.69	0.49	0.45
Ratio of current assets to current liabilities*	**1.3**	1.1	1.0	1.3	1.4
Number of registered shareholders*	**2,297**	2,308	2,114	2,130	2,392
Cash dividends paid per common share*	**$ 0.12**	0.12	0.11	0.10	0.10

QUARTERLY FINANCIAL INFORMATION

(unaudited) (amounts in millions of dollars except per share amounts)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2004				
Continuing operations				
Revenue	**$ 242.9**	**246.1**	**304.9**	**299.3**
Earnings	**$ 15.1**	**15.1**	**21.4**	**15.5**
Earnings per share	**$ 0.07**	**0.07**	**0.09**	**0.06**
Net earnings	**$ 13.2**	**15.1**	**21.4**	**14.3**
Basic and diluted net earnings per share	**$ 0.06**	**0.07**	**0.09**	**0.05**
Common share trading range:				
High	**$ 5.81**	**6.79**	**6.07**	**6.77**
Low	**$ 3.09**	**5.01**	**5.05**	**5.55**

(unaudited) (amounts in millions of dollars except per share amounts)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2003				
Continuing operations				
Revenue	$ 275.8	252.3	290.3	312.1
Earnings	$ 37.4	23.3	31.5	38.8
Earnings per share	$ 0.17	0.11	0.14	0.18
Net earnings	$ 37.4	23.3	31.5	25.0
Basic and diluted net earnings per share	$ 0.17	0.11	0.14	0.11
Common share trading range:				
High	$ 14.63	12.60	6.05	6.40
Low	$ 11.28	4.17	3.25	2.76

QuickLinks

Exhibit 2

MANAGEMENT AND AUDITORS' REPORTS
CONSOLIDATED BALANCE SHEETS
CONSOLIDATED STATEMENTS OF EARNINGS
CONSOLIDATED STATEMENTS OF RETAINED EARNINGS
CONSOLIDATED STATEMENTS OF CASH FLOW
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

QuickLinks -- Click here to rapidly navigate through this document

Exhibit 3

MANAGEMENT'S DISCUSSION AND ANALYSIS

May 11, 2004

For purposes of this discussion, "CAE" or the "Company" refers to CAE Inc. and its subsidiaries.

This Management's Discussion and Analysis ("MD&A") contains commentary from CAE management regarding strategy, operating results, and financial condition. Management is responsible for its accuracy, integrity and objectivity, and has developed, maintains and supports the necessary systems and controls to provide reasonable assurance as to the comments contained therein.

CAE's common shares are listed on the Toronto and New York stock exchanges. Except as otherwise indicated, all financial information related herein is determined in accordance on the basis of Canadian generally accepted accounting principles ("Canadian GAAP"). All dollar amounts referred to herein are Canadian dollars unless otherwise specified.

This MD&A is current as of May 11, 2004. Additional information relating to the Company, including its Annual Information Form ("AIF") is available online at www.sedar.com, as well as at the Company's website at www.cae.com.

This MD&A should be read in conjunction with the audited consolidated financial statements and notes to the consolidated financial statements for the 2004 fiscal year contained on pages 30 to 61. It focuses on the core business segments of CAE: Civil Simulation and Training ("Civil"), Military Simulation and Training ("Military") and Marine Controls ("Marine").

CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING INFORMATION

Certain information in this MD&A is forward-looking and is subject to important risks and uncertainties. Forward-looking information statements with respect to CAE and the operations of each of its business segments include information concerning the Company's future financial performance, business strategy, plans, goals and objectives. Statements preceded by the word "believe", "expect", "anticipate", "intend", "continue", "estimate", "may", "will", "should" and similar expressions are forward-looking statements.

This MD&A is based on assumptions, which CAE considered reasonable at the time they were prepared. Any forward-looking statements, by their nature, necessarily involve risks and uncertainties that could cause actual results to differ materially from those contemplated by the forward-looking statements. CAE cautions the reader that the assumptions regarding future events, many of which are beyond the control of CAE, may ultimately prove to be incorrect. The Company intends the forward-looking information to speak only as of the time first made and does not undertake to update or revise it whether as a result of new information, future events, or otherwise. Factors that could cause actual results or events to differ materially from current expectations are discussed herein — see the Business Risks and Uncertainties section of this MD&A for additional information.

BUSINESS OVERVIEW

In fiscal 2004, CAE faced numerous challenges. The combination of low demand in the commercial aerospace market, fierce competition and the 13% increase year over year in the Canadian dollar against its American counterpart have contributed to a reduction in the margins for each of the Company's business segments.

Civil ended the fiscal year with 16 full flight simulator orders (compared to 11 orders in the prior year) and a training network with an installed base of 102 simulators located in 21 locations on four continents. Civil achieved a 20% year-over-year growth of its training revenue when excluding the impact of currency adjustments. While the 13% growth in airline passenger traffic during fiscal 2004, the development of the new Airbus A380 and the rising level of new aircraft orders bode well for the future of the civil aviation industry, fiscal 2004 remained a year of recovery for the commercial airline industry.

Military almost doubled the amount of new orders in fiscal 2004 (over $500 million) versus fiscal 2003 and nearly 40% of these new orders came from the US market. Military's growth prospects were marred by the loss of two significant projects — Flight School XXI in the US and the Canadian CF-18 Advanced Distributed Combat Training System ("ADCTS"). The Canadian federal government's decision to grant the latter contract to a competitor was primarily responsible for CAE having to lay off approximately 300 employees in April 2004, located mostly in Montreal, for which a restructuring charge of $8.2 million was recorded in the fourth quarter of fiscal 2004. This amount, added to the $1.8 million of severance costs incurred earlier in the fourth quarter of fiscal 2004, brought the total restructuring cost for the year to $10.0 million.

Marine maintained its performance. The reduction in both revenue and earnings before interest, income taxes and discontinued operations was primarily due to the strengthening of the Canadian dollar against other currencies. Despite marginally lower revenues, Marine has maintained its percentage margins at the same levels as last year. Marine continued to record a high level of contract wins in its markets and its superior technology and execution has helped it to remain a market leader.

While fiscal 2004 was a difficult year, management remains determined to improve the Company's profitability. More orders for Civil simulators in fiscal 2004 and an increase in Civil training combined with the stronger order bookings for Military are encouraging.

BUSINESS PROFILE AND STRATEGY

CAE is a global leader in delivering "The Essential Edge" in safety, readiness and efficiency in three core markets: Civil, Military, and Marine. In the past four years, it has transformed itself from an equipment supplier to an integrated training solutions provider. In fiscal 2004, CAE derived 45% of its revenue from training services, compared to only 15% in fiscal 2001. This transformation has been enabled by CAE's strategic consolidation and introduction of new training capacity, innovative training courses and technologies, combined with its leading edge simulation equipment and software.

The Company is a leading civil aviation training solutions provider via its Civil business segment, which is a world leader in the design and production of commercial flight simulators and visual systems as well as the second largest supplier of integrated aviation training solutions to each market served — business aviation, regional and commercial airlines markets.

CAE is also a premier supplier of equipment, designer and manufacturer of military flight and land-based simulation, and of training services provided to more than 30 militaries globally. Simulation equipment and training are developed for a variety of military aircraft, including helicopters, transport planes and fighter jets. CAE has an extensive product range covering many American and European aircraft types.

The Company is also a leader in marine automation and control systems for both the naval and commercial markets, having been selected for the provision of controls for more than 140 warships in 18 navies and for over 450 high-end commercial vessels. These systems monitor and control the propulsion, electrical steering, ancillary, auxiliary and damage control machinery and systems of ships, such as Cunard's Queen Mary 2, the world's largest commercial cruiseship. Marine has also moved beyond the supply of equipment into the provision of naval training services through participation in the 30-year UK Royal Navy Astute Class Submarine Training Service program awarded in fiscal 2002. Marine also designs and manufactures power plant training simulators for the energy sector.

CAE's strategy is to "Refine, Execute and Grow". To do so, its three business segments are dedicated to increasing their value proposition to customers, and maintaining the strict cost containment and productivity guidelines to grow their business and improve their profitability.

Civil is expected to retain its number one ranking in providing flight simulators and visual systems equipment to the commercial and business aviation markets — having won 84% of the competed full flight simulator orders during fiscal 2004. It expects to grow its second place position in training services, by consolidating existing training market capacity and selectively adding new simulators as demand warrants. CAE also expects to grow its training revenue by marketing a complete training solution including courseware and instructors. CAE's leading-edge technology in training delivery, CAE Simfinity™, provides a basis for differentiating CAE's totally integrated training solution.

Military intends to broaden its core market through leveraging its recent success in the US with the US Army's Special Operations Forces, and expanding its offering of training services by leveraging CAE's technology offerings. Military is also expected to build further on opportunities it has together with its partner Thales on the European NH-90 helicopter program, for which the CAE-Thales team was recently selected. The total program is initially valued at $650.0 million for training equipment only. The contract contemplates training equipment requirements for 400 helicopters, however, CAE expects worldwide market demand may be more than double this. Maintenance services and training support will also be required for the NH-90 program which could generate additional revenues of $1.0 billion or more over the next 20 years.

Marine's strategic priorities will include expanding its scope of supply to include navigation sensors and/or electrical and communication systems, and to maintaining its leadership in product innovation. Penetrating new geographical markets, such as China, Japan, and Korea, together with winning a larger share of the mid-size commercial ships market will continue to be a priority as well.

BUSINESS RISKS AND UNCERTAINTIES

CAE operates in different industry segments that involve various risk factors and uncertainties, which are carefully considered in the Company's management policies.

CAE's success in civil aviation, military and marine markets depends fundamentally on the reliability of its products, the quality of its services and its ability to adapt, in a timely manner, to changing customer needs and industry standards. The Company operates in different industry segments and global markets that involve various risk factors and uncertainties, including worldwide economic and political trends and developments.

CAE operates in the civil simulation equipment and training services markets, both of which are heavily dependent on demand for air transportation and the financial condition of commercial airlines. The major airline bankruptcies in Europe, the US, Canada and other CAE markets pose risks to CAE as an unsecured vendor and/or service provider to these and other potentially insolvent customers. Demand for simulation equipment tends to follow the trend established in the commercial airline industry, particularly the delivery of new aircraft. Any reduced demand may in turn lead to reduced production levels, which impacts margins negatively. The utilization of CAE's installed base of simulators in its training network depends on the extent to which simulated aircraft types match the configuration of in-use aircraft, as well as on the overall level of commercial air traffic.

CAE must comply with rules imposed by regulatory authorities that may change without notice, resulting in potential disruptions to sales and operations. The sale or licence of virtually all of CAE's products is subject to various regulatory controls that change with some frequency.

CAE's Military and Marine businesses depend heavily on government programs and contracts that ultimately reflect the level of government expenditures directed towards national defence budgets (particularly capital equipment programs), the priority of various programs within defence budgets and, in certain instances, the maintenance of government programs supporting research and development. Programs may be only partially funded pending future appropriations and may contain provisions permitting termination at the government's convenience, in whole or in part, without prior notice, upon payment of limited compensation. Government-funded military programs are also heavily regulated, with certain government purchasing regulations limiting the range of reimbursable costs in fixed-price contracts, including most financing costs and the amortization of various intangible assets.

CAE operates in intensely competitive markets. Some of its competitors, particularly in military markets, possess substantially greater resources, well-established relationships with various procuring organizations and a greater in-country presence that may give them an advantage in winning contracts.

CAE's often lengthy and unpredictable sales cycle could result in volatility in its operating results. The Company must invest significant amounts of time and resources educating and informing potential customers about the benefits of products and services (particularly government agencies with lengthy internal budgeting approval and competitive evaluation processes), with no guarantee of compensatory revenue.

CAE's business could be harmed if its products do not successfully integrate or operate with other sophisticated and continually evolving software, computing and communications systems. If CAE experiences difficulties or does not meet project milestones in a timely manner, the Company could be obligated to devote more engineering and other resources to a particular project than originally anticipated. While CAE believes it has recorded adequate provisions for losses on fixed-price contracts, obligations under fixed-price and long-term supply contracts could subject the Company to contract losses in excess of provisions.

CAE's ability to complete contracted sales included in its order backlog is dependent on the long-term financial condition of the contracting customers. In addition, approximately 60% of the backlog comprises long-term contracts where revenues are guaranteed or expected, based on current customer requirements. Those contracts may be terminated unilaterally by the contracting customer.

CAE's ability to protect its intellectual property is limited; and unauthorized parties may be able to use CAE's technology or products in ways that weaken CAE's competitive position. Reliance on the intellectual property of others, including data concerning the functions, design and performance characteristics of a product or system in the process of being simulated, could prevent or delay performance. Future litigation related to the defence of CAE's intellectual property rights or involving infringement claims brought against CAE or a customer could be lengthy and costly, with no assurance of success.

CAE is subject to the risks of doing business in foreign countries, including: changes to laws and regulations in host countries; the cost and complexity of using foreign representatives and consultants; the imposition of tariffs, embargoes, controls and other restrictions impeding the free flow of goods, information and capital; the difficulties of managing and operating an enterprise and complying with laws in multiple jurisdictions; and general changes in economic and geopolitical conditions. Fluctuations in the value of the Canadian dollar relative to foreign currencies could result in currency exchange gains and losses. Current hedging activities may not be successful.

Covenants in CAE's debt agreements as well as the level of debt could restrict CAE's ability to finance its future operations or capital needs or to engage in other business activities that may be of interest. In addition, an inability to meet financial covenants regarding compliance with specified ratios and tests could cause the repayment of debt to be accelerated.

CAE may be subject to significant liabilities imposed by new environmental laws and regulations or contractual indemnities; product liability and warranty claims; or liabilities arising out of accidents or disasters involving aircraft, marine vessels or power plants for which CAE has provided training products or services or control systems. CAE cannot be certain that existing insurance coverage will be sufficient to cover one or more substantial claims.

CAE's continued success will depend in part on the ability to retain and attract key personnel with the relevant skills, expertise and experience. The Company applies a compensation policy designed to mitigate this risk.

NON-GAAP FINANCIAL MEASURES

This MD&A provides comments as to how the impact of the appreciation of the Canadian dollar against its United States counterpart affected the Company's results of fiscal 2004 as compared to fiscal 2003. The Company believes that this is useful supplemental information as it provides an indication of performance excluding such currency fluctuation. Readers should be cautioned however that this information should not be confused with or used as an alternate for performance determined in accordance with GAAP.

Free cash flow does not have any standardized meaning prescribed by GAAP. It is therefore unlikely to be comparable to similar measures presented by other companies. Free cash flow is presented on a consistent basis from period to period. CAE considers free cash flow to be an indicator of the financial strength and performance of its business as it shows how much cash is available to repay debt and to reinvest in the Company.

OVERALL PERFORMANCE
REVENUE

For fiscal 2004, consolidated revenues decreased by 3% to $1.093 billion compared to the preceding year. Excluding the impact of the US dollar fluctuation against the Canadian dollar, consolidated revenue would have exceeded that of the prior year by just over 4%.

Civil's 11% or $55.4 million year-over-year revenue decline was attributable to adverse market conditions resulting in much lower equipment sales, partially offset by higher training revenue. Excluding the impact of foreign exchange fluctuations, Civil's revenue for the year would have been $517.5 million, in line with last year. The 6% or $27.1 million increase in Military's revenue was attributable to higher activity from support services and on certain land-based programs in Germany. Military's revenue for the year would have been $496.1 million had it not been for the impact of foreign exchange. The $9.0 million or 5% decrease in Marine's revenue is explained by the $10.0 million contribution last year on the completion of the Frigate 124 program in Germany, combined with current delays on the Astute and FAST Astute Class Training Services (ACTS) programs, as the manufacturing of the submarine itself is behind schedule. Revenue for Marine would have been $7.3 million higher than actual results when the impact of foreign exchange is excluded.

EARNINGS BEFORE INTEREST, INCOME TAXES AND DISCONTINUED OPERATIONS (EBIT)

Year-to-date EBIT amounted to $111.6 million compared to $221.6 million reported in fiscal 2003. EBIT was reduced by a $10.0 million restructuring charge related to the company's workforce reductions. This charge relates mainly to the workforce reduction in the Montreal plant of approximately 250 employees, following the Canadian government decision to attribute the CF-18 simulation equipment contract to a competitor.

The results of all of CAE's business segments were also impacted for the year by the substantial and rapid appreciation of the Canadian dollar's value relative to the US dollar. This impact was approximately $28.9 million.

The decline in consolidated earnings before interest, income taxes and discontinued operations relative to the prior year was attributable to a substantially lower contribution from Civil, as the latter was affected by a significant reduction in equipment volumes, lower selling prices combined with the effect of a stronger Canadian dollar. Military's earnings before interest, taxes and discontinued operations (EBIT) on a year-over-year basis was down by 29% as a result of lower margins, which were expected based on the current mix of a significant number of new programs. Marine reported a 7% decrease in EBIT over the prior year, mostly due to the foreign exchange impact referred to above.

Other contributing factors to lower EBIT were an increase of $2.6 million in pension expense in the first half of the fiscal year, caused by the decrease in the rate of return on plan assets for defined benefit pension plans from 9.0% to 6.5%, combined with additional costs of $6.8 million for long-term incentive compensation. The latter increase was a result of the year-over-year change in value of outstanding deferred share units and from prospectively expensing stock options on April 1, 2003 using the fair value method.

INTEREST AND INCOME TAXES

For the fiscal year, interest expense decreased to $23.9 million from $30.4 million in the prior year due to lower debt levels. The annual results benefited from a reduction in the income tax rate to 24% as compared to 31% in fiscal 2003. The tax rate was influenced by tax benefits recorded on prior years' tax losses in Australia in the first quarter, as well as a change to the mix of income for income tax purposes from various jurisdictions.

DISCONTINUED OPERATIONS

During the year, CAE incurred a loss from discontinued operations of $3.1 million or 2 cents a share compared with $13.8 million or 7 cents a share last year. The Company completed the sale of the last of its discontinued operations during fiscal 2004. The loss was caused by post-closing adjustments from the sale of CAE's former German Cleaning Technologies operations for $2.6 million and $0.5 million relating to the pension plan curtailment cost for the divestiture of the Canadian operations of the former Forestry businesses.

NET EARNINGS

Year-to-date consolidated net earnings amounted to $64.0 million compared to $117.2 million last year, reflecting the components discussed previously in this section of the MD&A.

The results of all of CAE's business segments were also impacted by the substantial and rapid appreciation of the Canadian dollar's value relative to the US dollar. Compared to the prior year, CAE's earnings per share were reduced by 11 cents or approximately $24.6 million in aggregate, as a result of that currency fluctuation.

CASH FLOW AND FINANCIAL CONDITION

CAE's net debt, defined as long-term debt less cash and cash equivalents and short-term investments, decreased by $216.7 million compared to March 31, 2003. The reduction was accomplished from the receipt of approximately $168.0 million net of fees and expenses from the issuance of common shares and $122.5 million from sale and leaseback transactions. This was offset by lower cash from operations as compared to last year resulting from lower earnings and an increase in non-cash working capital. Free cash flow (net cash provided by continuing operating activities less capital expenditures and dividends paid) improved by $10.4 million on a year-over-year basis.

A lower level of accounts payable and accrued liabilities due to lower civil equipment activity mainly explains the increase in non-cash working capital. The latter was compounded by higher accounts receivable, from unbilled sales on certain Military and Marine programs and by an increase in inventories, primarily for the advance build of Civil simulators.

Capital expenditures for the year amounted to $94.5 million, compared to $238.9 million in the prior year. The majority of the expenditures were for the expansion of the Civil training services business.

BACKLOG

Backlog for comparative purposes has been restated. For a detailed discussion on the issues regarding the restatement see Civil's section of this MD&A. CAE's consolidated backlog as at March 31, 2004, was $2.9 billion, $160.8 million higher than last year's level.

SELECTED ANNUAL INFORMATION

(amounts in millions of Canadian dollars except per share amounts)	2004	2003	2002
Operating results			
Continuing operations			
Revenue	**$ 1,093.2**	$ 1,130.5	$ 1,126.5
Earnings	**67.1**	131.0	148.4
Net earnings	**64.0**	117.2	149.5
Financial position			
Total assets	**$ 2,293.3**	$ 2,356.5	$ 2,378.4
Total long-term debt, net of cash	**575.0**	794.3	837.7
Per share			
Earnings from continuing operations	**$ 0.29**	$ 0.60	$ 0.68
Net earnings	**0.27**	0.53	0.69
Dividends	**0.12**	0.12	0.11
Shareholders' equity	**3.94**	3.42	2.81

REVENUE

In fiscal 2004, consolidated revenues decreased by 3% to $1.093 billion compared to the preceding year and to fiscal 2002.

Civil's revenue decline to $461.8 million this year from $545.2 million in fiscal 2002 and $517.2 million in fiscal 2003 was due to adverse market conditions resulting in much lower equipment sales partially offset by higher training revenue. Civil's operations were greatly influenced by the financial health of the commercial airline industry. Over the past few years, the industry has been affected by the impacts of terrorist attacks, SARS, and the Iraq war. The worst is likely over as evidenced by recent increases in passenger loads. These events have resulted in increased needs for, and for the training of, regional jet pilots. With its wide array regional jet FFS, Civil believes it is well positioned to take advantage of these future trends.

Military recorded a 6% and 2% increase in revenue compared to fiscal 2003 and 2002 respectively, to reach $472.8 million in fiscal 2004. Military's increases were attributable to higher activity from support services and to land-based programs in Germany.

The decrease in Marine revenue of 5% compared to the prior year was a result of the currency impact and from a significant contribution on the completion last year of the Frigate 124 program in Germany ($10.0 million). Marine's increase of $48.1 million in fiscal 2003 compared to fiscal 2002 was due to the growth of its naval control business with increasing contributions from the Company's activities on the Astute program and from increased contributions from the then newly acquired CAE Valmarine.

The appreciation of the Canadian dollar against its US counterpart has had a significant impact on revenues in fiscal years 2003 and 2004. The average US foreign exchange rate used by CAE was $1.35, $1.55 and $1.57 for fiscal years 2004, 2003 and 2002 respectively, for a total appreciation of 14% over that time period.

EBIT

Consolidated EBIT amounted to $111.6 million in fiscal 2004 compared to $221.6 million reported in fiscal 2003 and $241.0 million reported in fiscal 2002. The decreases were a result of a significant reduction in equipment volumes and lower selling prices in Civil, along with a lower margin program mix in Military compared to the prior two fiscal years.

Civil's EBIT dropped to $39.4 million down $76.8 million and $119.4 million compared to last year and fiscal 2002 respectively. Military's EBIT was down 29% to $52.6 million compared to last year and off by $13.0 million compared to fiscal 2002. Marine's EBIT amounted to $29.6 million, off slightly from last year's EBIT of $31.8 million, but 25% higher than in fiscal 2002.

On a consolidated basis, fiscal year 2004's EBIT before restructuring charges of $10.0 million was $121.6 million, down 45% compared to last year. Restructuring charges consist of severance and other involuntary termination costs. These costs related mainly to the workforce reduction in the Montreal plant of approximately 250 employees, following the Canadian government decision to award the CF-18 simulation equipment contract to a competitor.

DISCONTINUED OPERATIONS

Loss from discontinued operations amounted to $3.1 million or 2 cents a share compared with $13.8 million or 7 cents a share last year and a gain of $1.1 million in fiscal 2002. See note 3 for detailed descriptions of significant disposals, the majority of which were disposed of in fiscal 2003.

SIGNIFICANT CHANGES IN ACCOUNTING POLICY

In fiscal 2004, the Company adopted the CICA Handbook Section 3870 *Stock-based Compensation and Other Stock-based Payments* issued in June 2003 and expensed prospectively the cost of stock options granted to employees using the fair value based method. A compensation expense is recognized for the Company's portion of the contributions made under the Employee Stock Purchase Plan and for amounts due under the Deferred Share Unit and Long-Term Incentive — Deferred Share Unit plans. In fiscal 2004, CAE recognized an expense of $1.3 million as a result of the adoption of this Handbook Section.

In fiscal 2003, the Company changed the amortization period for Civil simulation equipment from 20 years to 25 years, to reflect the approximated useful life of the simulators. This change reduced the amortization expense by approximately $3.7 million in fiscal 2003 compared

to fiscal 2002.

In fiscal 2003, the Company adopted retroactively the new recommendations of the CICA Section 1650, *Foreign Currency Translation*. Under the provisions of Section 1650 the Company no longer amortizes the exchange gains or losses arising on the translation of long-term foreign currency debt. Exchange gains or losses arising on translation are included in earnings as incurred. At March 31, 2002, the unamortized exchange loss relating to the existing long-term foreign currency denominated items amounted to $6.4 million net of income taxes of $2.8 million. Consequently, prior years' financial statements have been restated through a charge to fiscal 2002 opening retained earnings of $5.3 million, net of taxes of $2.3 million (2001 — $3.3 million, net of taxes of $1.3 million).

ACQUISITIONS AND DIVESTITURES

During fiscal 2002, the Company completed four strategic acquisitions, two of which accelerated the Company's move into aviation training, one which significantly improved the Company's access to the US defence market and one which provided immediate entry into the commercial marine control systems market (refer to note 2 of the audited consolidated financial statements).

From fiscal 2002 to fiscal 2004, CAE divested its non-core related businesses, mainly in the forestry and cleaning technologies markets (refer to note 3 of the audited consolidated financial statements).

REPOSITIONING FOR VALUE

Over the past three fiscal years CAE has continued to invest in its installed simulator base. As a result, the Company's revenue is less subject to cyclical industry fluctuations typical of an equipment supplier. As training revenue continues to grow, CAE's profile has changed to that of a service provider where revenues are more consistent over the fiscal year. As the proportion of CAE's training service revenue mounts, the third quarter is gradually becoming the Company's strongest as a result of seasonally high training volume during the fall months, recovering from the quieter summer period when less training occurs as pilots are not available for training during the peak summer travel period. Furthermore, CAE has now transformed itself from a pure manufacturer to an integrated manufacturing/service offering business.

RESULTS OF OPERATIONS — FISCAL 2004
CIVIL

Civil is a world leader in the design and production of commercial flight simulators, visual systems and a world-leading supplier of integrated aviation training solutions. As at March 31, 2004, CAE has an installed base of 102 FFS (89 FFS as at March 31, 2003) at 21 locations on four continents, making it the second largest independent training company in the world in each segment — business aircraft, regional jets and wide body aircraft. CAE also remains the leading provider of FFS to the competed market.

Operational Highlights

Civil continues to grow its number two position in training services, having grown its installed base of FFS by 15% during fiscal 2004, which compares to 50% growth in fiscal 2003. The signature of several training services contracts validated this growth strategy during the year, most notably a $35.0 million award by Flight Options LLC, a leading provider of fractional shares in business aircraft, of a three-year exclusive contract to train at CAE SimuFlite's Dallas training centre. About $20.0 million worth of service contracts were won by CAE in the Asia Pacific region, along with more than $55.0 million of training services contracts signed in the Europe and Middle East region, most notably at the Emirates-CAE Flight Training Centre in Dubai, United Arab Emirates.

Civil's investment in the next generation technology for FFS, CAE Sim XXI™, designed to simplify assembly, testing and integration of FFS, and to reduce life cycle costs for simulator operators, was validated. Both Europe's Joint Aviation Authorities and the US Federal Aviation Administration ("FAA") approved in November 2003 the first CAE Sim XXI™ level D-qualified simulator, a Gulfstream IV FFS located in the Emirates-CAE Flight Training Centre. This first qualification was soon followed by others, a Gulfstream V FFS also located in Dubai, and a Boeing 737-800 FFS located in Ryan Air's East Midlands Airport training facility, this time level D-qualified by the UK's Civil Aviation Authority.

The CAE Simfinity™ products, high-fidelity simulation-based software that allows for advanced training on procedure trainers in groundschool and over the Web, also proved to be another successful invention for CAE, as it has become a market differentiator for its integrated training solutions offering. Simfinity™-based devices were a key part of the range of training services offered to Airbus as part of the development of the world's first A380 FFS. Furthermore, the FAA will also use a Boeing 737-800 CAE Simfinity™ integrated procedure trainer in its own research.

During fiscal 2004, CAE signed a contract with Airbus to develop the world's first A380 FFS. As part of this $55.0 million contract, a complete range of training devices will be provided for the A380, including two FFS equipped with the CAE Tropos™ visual system and Simfinity™ software licences for desktop and laptop trainers.

JetBlue Airways awarded CAE an $85.0 million contact, one of CAE's largest-ever orders for FFS, for the manufacture of six FFS, and selected CAE as its exclusive supplier for a period of 10 years. Southwest Airlines selected CAE for a $25.0 million contract for a Boeing 737-700 FFS and related flight training devices.

There were 16 FFS ordered this year (out of a total possible number of 19 FFS competed for), up from 11 last year. CAE's 84% FFS market share, together with its 80% share of the visual systems market, gives Civil the number one ranking in providing flight simulators and visual systems equipment to the competed commercial and business aviation markets.

Results of Operations

(amounts in millions of Canadian dollars, except operating margins)		2004	2003	2002	2001	2000
Revenue	$	**461.8**	517.2	545.2	481.5	480.2
EBIT	$	**39.4**	116.2	151.8	115.8	82.9
Operating margins	%	**8.5**	22.5	27.8	24.0	17.3
Backlog	$	**1,021.3**	877.1	805.6	656.9	635.4
Capital expenditures	$	**83.5**	207.6	216.7	72.9	11.7

Civil's revenues for the year amounted to $461.8 million, 11% or $55.4 million below last year due to weak equipment sales. The decrease in equipment revenues was primarily due to the continuing difficulties in the commercial aerospace market, resulting in severe competition and downward pricing pressure. Training continued its growth with an increase in the number of simulators deployed in the network, as well as a notable increase in utilization in the latter part of the year, which should carry over into the next fiscal year. Excluding the effects of foreign exchange, revenue would have reached $517.5 million, in line with last year.

EBIT of $39.4 million for the year was 66% ($76.8 million) lower than last year. Civil experienced difficult market conditions during the fiscal year due to the residual effects of the SARS epidemic, the Iraq war, terrorist attacks, and the large number of airlines in financial difficulty. In addition, the accounting for sale and leaseback financing reduced Civil's margins by 500 basis points as these operating lease payments include an interest component and are accounted for in EBIT. On the positive side, overall utilization rates of its installed simulator base have continued to increase throughout the year to finish at 64%, 400 basis points higher than last year. Civil has been hard hit by foreign exchange fluctuations. Excluding the effects of foreign exchange, Civil's EBIT for the year would have reached $69.8 million, $30.4 million higher than actual results.

Backlog for Civil consists of both equipment sales and training services. Civil's backlog has been restated to include the training services portion which includes revenues from customers under both long- and short-term contractual arrangements where training revenues are guaranteed or expected based on current customer requirements.

Backlog at the end of this fiscal year totalled $1,021.3 million, up $144.2 million from $877.1 million at March 2003.

Capital expenditures for the year amounted to $83.5 million, compared to $207.6 million in the prior year. The majority of the expenditures were for the growth of the Civil training business. In fiscal 2003, the installed base increased from 59 to 89 FFS. In the current year, the Company has reduced its expenditures in response to the current market environment.

MILITARY SIMULATION AND TRAINING

Military is a premier designer and manufacturer of military flight and land-based simulation and training systems. Simulation equipment and training is developed for a variety of military aircraft, including helicopters, transport planes and fighter jets. CAE has an extensive product range covering many American and European weapon systems. The customer base is extensive as well, CAE having made sales to over 30 countries globally.

Operational Highlights

New orders in fiscal 2004 exceeded $500.0 million despite the loss of two important contracts: Flight School XXI and CF-18 ADCTS. Programs margins returned to a more normalized level, as had been expected following fiscal 2003, where a number of contracts were completed and with Military achieving an early delivery bonus on one program.

In the fourth quarter of fiscal 2004, NHI Industries ("NHI") selected the CAE-Thales Training and Simulation team as the preferred bidder to provide a range of NH-90 helicopter training systems throughout Europe in a contract worth approximately $650.0 million. This selection re-affirmed CAE's technology leadership for rotary-wing FFS. NHI is managing the procurement of the NH-90 training systems for the NATO Helicopter Management Agency ("NAHEMA") and the Nordic Standard Helicopter Program ("NSHP"). NAHEMA represents the governments of Germany, Italy, France, the Netherlands, and Portugal, while NSHP represents Norway, Sweden and Finland. Contract negotiations are in progress, and once completed the value of the order will be included in backlog.

Early in fiscal 2004, CAE announced that Rotorsim, a consortium equally owned by CAE and Agusta S.p.A., would establish a new helicopter training facility in Italy to provide integrated training solutions for AgustaWestland helicopters. The Rotorsim facility will open in calendar year 2005 with the delivery of a CAE-build A109 full mission simulator and is expected to generate revenues of $125.0 million over 15 years.

Military continues to expand its training services offerings at a number of NATO bases in Germany and in the US at various Air Force bases. In fiscal 2004, Military added Australia to CAE's client service base, as it was awarded a 10-year, $70.0 million agreement to provide flight training support services for all three armed services for the Australian Defence Force.

During fiscal 2004, Military received contracts valued at more than $170.0 million including options, under a long-term agreement with Lockheed Martin, to provide additional C-130J training devices and training support for the US Air Force. In addition, under that same agreement, a contract valued at more than $50.0 million with options was signed to provide KC-130J Weapon Systems Trainers to the US Marine Corps.

The US Army's Program Executive Office — Simulation, Training and Instrumentation awarded CAE contracts worth more than $70.0 million to provide an MH-47G Chinook combat mission simulator ("CMS"), begin design for refurbishment and upgrade of the existing MH-60K Black Hawk CMS, and provide desktop trainers and a reconfigurable part-task trainer for the Chinook and Black Hawk helicopters.

CAE's Magnetic Anomaly Detection ("MAD") system generated more than $20.0 million in orders in fiscal year 2004. MAD was selected for the Turkish Navy's new CN235 aircraft and any additional maritime patrol aircraft procured by Turkey. It was also chosen for the Canadian Forces CP-140 Aurora Incremental Modernization program in a contract worth approximately $10.0 million. MAD will also be used in the new maritime patrol aircraft for the Japan Defence Agency ("JDA"). The latter's initial contract is valued at more than $7.0 million, with potential follow-up business valued at over $30.0 million depending on the number of aircraft procured by the JDA.

Results of Operations

(amounts in millions of Canadian dollars, except operating margins)		2004	2003	2002	2001	2000
Revenue	**$**	**472.8**	445.7	461.8	329.3	309.6
EBIT	**$**	**52.6**	73.6	65.6	18.8	2.2
Operating margins	**%**	**11.1**	16.5	14.2	5.7	0.7
Backlog	**$**	**1,270.2**	1,253.3	1,378.3	971.9	1,048.4
Capital expenditures	**$**	**5.1**	12.1	14.1	1.8	9.6

Military's revenue for the year amounted to $472.8 million, $27.1 million higher than last year's $445.7 million. Strong performance was realized in service programs such as the CF-18 System Engineering Support program and Australian Defence Force Aerospace Simulation contract. Excluding the foreign exchange effect, revenue would have amounted to $496.1 million or $23.3 million higher than actual results.

EBIT for the year amounted to $52.6 million, a $21.0 million or 29% decrease from the prior year. Higher marketing expenses for bids on major projects adversely affected these results. In addition, a change in the mix of programs, which currently are at the initial stage versus several programs at or near completion last year, impacted operating earnings. Approximately $4.8 million of the variance in cumulative EBIT is attributable to foreign exchange fluctuation.

Backlog remained in excess of $1.2 billion as at March 31, 2004. This year's order intake of $507.1 million, 40% from the US market, reflects the award of several strategic contracts. This fiscal year's order intake was 78% higher than that of last year.

MARINE CONTROLS

Marine is a world leader in the supply of automation and control systems for both naval and commercial markets, having been selected to provide controls for almost 140 warships in 18 navies and over 450 commercial ships. Automation systems monitor and control the propulsion, electrical steering, ancillary, auxiliary and damage control systems while navigation systems allow a ship's crew to plan and navigate safe and efficient passage through the integration of electronic nautical charts with onboard sensors. The business has moved beyond the supply of marine controls into the provision of naval training services through participation in the 30-year UK Royal Navy Astute Class Submarine Training (Astute) program awarded in fiscal 2002 and submarine training in Canada. The business also designs and manufactures power plant training simulators.

Operational Highlights

Continuing its successful participation on multi-year ship programs, Marine was selected for additional delivery of shipboard control systems by the Republic of Korea Navy ("ROKN"). This marked the fifth contract in a series of KDX-II class destroyers, and the tenth selection of CAE's integrated platform management system for the ROKN.

Marine has established long-term relationships with its customers, as well as shipbuilders. This is well illustrated by the contracts obtained this year with the US Navy. Under the latter's DD(X) program, Marine was selected to provide its integrated platform management system technology through two contracts for the engineering control system and the fire suppression system valued at $25.0 million. Marine was also selected to supply $12.0 million of electric plant control systems for the largest and most advanced warships in naval history, the Nimitz-class aircraft carrier USS George H.W. Bush, as well as for the US Navy's LPD 21 USS New York, the latest LPD 17 class amphibious ship.

Marine continues to maintain leading position in the supply of control systems for cruiseships. It won contracts during the year worth $8.5 million to supply Damatic™ automation systems for installation in five vessels, with one being the world's largest cruise ferry, owned by Norway's Color Line.

In early 2004, the largest passenger ship ever built, the Queen Mary 2, began its service life. Aboard this ship is one of the largest marine control system implementations ever, CAE's software-based integrated automation system, which controls all of the Queen Mary 2's vital machinery, electrical and safety systems.

CAE's power simulation group, representing about 10% of the Marine business in fiscal 2004, continues its focus on the upgrade market. It is performing the largest single power-plant simulator upgrade in the US since 1992 on Detroit Edison's Fermi2 simulator in Michigan. In fiscal 2004, CAE became the premier supplier of power-plant simulation technology in the US when the power simulation group was selected to refurbish the Fort Calhoun simulator of the Omaha (Nebraska) Public Power District.

Results of Operations

(amounts in millions of Canadian dollars, except operating margins)		2004	2003	2002	2001	2000
Revenue	$	**158.6**	167.6	119.5	80.6	75.3
EBIT	$	**29.6**	31.8	23.6	15.0	13.6
Operating margins	%	**18.7**	19.0	19.7	18.6	18.1
Backlog	$	**610.2**	628.5	676.4	131.4	170.9
Capital expenditures	$	**5.9**	19.8	18.8	1.6	0.5

Marine's revenues for the year of $158.6 million declined by 5% compared to last year. The decrease is a result of customer delays in the Astute and FAST Astute Class Training Services (ACTS) programs, which consequently lead to delays in recognition of revenues. In addition, cumulative revenue has been negatively impacted by foreign exchange fluctuations by approximately 5% or $7.3 million.

Marine's segmented EBIT of $29.6 million for the year was $2.2 million below the same period last year. The year-over-year decline is primarily due to a negative foreign exchange effect of approximately $2.1 million. Excluding any foreign exchange impacts, EBIT would have been $31.7 million, in line with last year's results.

The backlog decreased slightly by $18.3 million to $610.2 million compared to last year.

Capital expenditures amounted to $5.9 million compared to $19.8 million last year, mainly due to the delays encountered with the FAST ACTS program.

Selected Quarterly Financial Information (Unaudited)

Selected quarterly financial information for the eight most recently completed quarters ending March 31, 2004 is disclosed below:

SELECTED QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

(in millions of Canadian dollars, unless otherwise noted)	1st	2nd	3rd	4th	FY 2003	1st	2nd	3rd	4th	FY 2004
Revenue	275.8	252.3	290.3	312.1	1,130.5	**242.9**	**246.1**	**304.9**	**299.3**	**1,093.2**
Earnings from continuing operations	37.4	23.3	31.5	38.8	131.0	**15.1**	**15.1**	**21.4**	**15.5**	**67.1**
Net earnings per share (basic and diluted) from continuing operations	0.17	0.11	0.14	0.18	0.60	**0.07**	**0.07**	**0.09**	**0.06**	**0.29**
Net earnings	37.4	23.3	31.5	25.0	117.2	**13.2**	**15.1**	**21.4**	**14.3**	**64.0**
Net earnings per share (basic and diluted)	0.17	0.11	0.14	0.11	0.53	**0.06**	**0.07**	**0.09**	**0.05**	**0.27**
Average number of shares outstanding, in millions	219.3	219.4	219.4	219.4	219.4	**219.7**	**220.0**	**246.5**	**246.6**	**233.2**
Average exchange rate, 1 US dollar to 1 Cdn dollar	1.56	1.56	1.57	1.51	1.55	**1.40**	**1.38**	**1.32**	**1.32**	**1.35**

As CAE has transformed itself from a pure manufacturer to an integrated manufacturing/service offering business, its quarterly results will have less volatility as the training services business is more stable than being a supplier of equipment in a cyclical market. As training services grow and become a larger part of CAE's business, second quarter results will be lower than other quarters as less training services are required during the peak flying times of the traditional vacation periods.

However, CAE's net earnings do not follow the seasonal training pattern as they are affected by equipment results, which can vary widely from quarter to quarter depending on progress made on contracts, and the timing of product delivery, together with their related margins. Furthermore, operating results may also be impacted by high sales and marketing activities in a quarter, depending on the bidding activities during the quarters.

As a general trend, the military aerospace market is expected to remain strong, with governmental budgets remaining high for the foreseeable future. The large civil aerospace and business aircraft markets have been in a downturn from which they are expected to begin recovery by calendar 2006. In fiscal 2004, air passenger traffic climbed 13% globally, an indication that the civil aerospace industry is stabilizing.

The decline in earnings compared to the prior year, starting in the first quarter of fiscal 2004 as compared to the prior quarters corresponds in timing to the significant weakening in the value of the US dollar against the Canadian dollar. The increase in the average number of shares outstanding, resulting from the issuance of common shares on September 30, 2003, impacted the earnings per share for fiscal 2004.

LIQUIDITY

The Company's financing needs are met through internally generated cash flow, available funds under credit facilities and direct access to capital markets for additional long-term capital resources. CAE considers that its present and expected capital resources and current credit facilities will enable it to meet all its current and expected financial requirements for the foreseeable future.

The Company plans to generate sufficient cash from operating activities to pay for capital expenditures and dividends. CAE expects to be able to repay contractual obligations maturing in 2005 and future years through cash on hand, cash generated from operations or by issuing new debt.

DIVIDENDS

CAE expects to pay annual dividends of approximately $30.0 million assuming the current number of common shares outstanding and the current dividend policy. These dividends are equal to $0.12 per common share on an annual basis, based on approximately 246 million common shares at March 31, 2004.

CONTRACTUAL OBLIGATIONS

The table below is a summary of the Company's contractual obligations as at March 31, 2004, that are due in each of the next five years and thereafter.

Contractual Obligations (unaudited)

(amounts in millions of Canadian dollars)	Total	Less than 1 Year	1 - 3 Years	4 - 5 Years	More than 5 Years
Long-term debt	613.2	11.5	343.7	39.2	218.8
Capital lease	23.7	2.0	4.1	3.2	14.4
Operating leases	814.8	92.2	174.1	134.8	413.7
Purchase obligations	73.7	27.0	20.2	17.1	9.4
Other long-term obligations	17.3	4.0	5.2	4.3	3.8
Total	1,542.7	136.7	547.3	198.6	660.1

The long-term debt includes $305.3 million drawn under CAE's committed credit facilities maturing in fiscal 2007. The total availability of the committed credit facilities is equal to $619.8 million.

Rental expense related to operating lease was $92.5 million in fiscal 2004 compared to $87.4 million in fiscal 2003. The sale and leaseback of certain FFS installed in the Company's global network of training centres accounted for $41.7 million of the total rental expense.

Other purchase obligations are related to agreements to purchase goods or services that are enforceable and legally binding on CAE and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Principally, the purchase obligations are related to agreements with subcontractors to provide services in the context of long-term contracts with the Company's clients.

Other long-term obligations include a total of $10.5 million of repayments under various government assistance programs.

At March 31, 2004, CAE had other long-term liabilities that were not included in the table. They consisted of some accrued pension liabilities and post-retirement benefits, deferred revenue and gains on assets and various other long-term liabilities. Cash obligations of accrued employee pension liability and post-retirement benefits depend on various elements such as market returns, actuarial losses and gains and interest rate. As a result, management cannot accurately determine the timing and amount of cash needed for them. Future income tax liabilities were not included since future payments of income taxes depend on the amount of taxable earnings and on whether there are tax loss carryforwards available to reduce income tax liabilities.

As at March 31, 2004, the Company had approximately US$130.7 million of accumulated non-capital tax losses carried forward that can be used to offset tax payable on future earnings from US operations. CAE also had accumulated non-capital tax losses carried forward relating to its operations in other countries of approximately $57.4 million.

CAPITAL RESOURCES

SOURCES OF LIQUIDITY

CAE maintains committed bank lines at floating rates, each provided by a syndicate of lenders. These credit facilities permit the Company and certain designated subsidiaries to borrow funds directly for operating and general corporate purposes. The total available amount of committed bank lines at March 31, 2004, was $619.8 million of which 49% ($305.3 million) was utilized. At March 31, 2003, the total available amount was $872.8 million, of which 52% ($451.9 million) was utilized. The decrease in total availability was due to the final repayment of $51.4 million (US$35.0 million) in June 2003, of a bridge facility of US$135.0 million. The decrease in total utilization was mainly due to the repayments made possible by the sale and leaseback transactions of $122.5 million completed in the first half of the year as well as the equity offering completed in September 2003 for an amount of $175.0 million representing 26.6 million shares.

CAE was in full compliance with all bank covenants at March 31, 2004. It also had the ability to borrow under non-committed operating lines in various currencies for up to $28.2 million, of which $6.4 million was drawn as at March 31, 2004. Both the availability and utilization were lower than at March 31, 2003, where they stood at $89.0 million and $41.3 million respectively.

As at March 31, 2004, CAE had long-term debt totalling $636.9 million, compared to long-term debt of $811.4 million at March 31, 2003. At March 31, 2004, the short-term portion of the long-term debt was $13.5 million compared to $13.4 million at March 31, 2003.

COMMITMENTS

CAE's commitments for capital expenditures include investments to add new facilities to its training centre network in order to meet customer demand. Research and development expenditures are incurred to provide new products to the marketplace, as alternative ways of training are developed and different types of simulators are needed for our clients' training needs.

OFF-BALANCE SHEET ARRANGEMENTS

GUARANTEES

In the normal course of business, CAE issued letters of credit and performance guarantees for a total amount of $207.7 million at March 31, 2004, compared to $195.1 million at March 31, 2003. The increase was due to a large guarantee issued as credit support for the benefit of the owner participant in the September 30, 2003 sale and leaseback transaction, offset by a reduction in advance payment and contractual performance guarantees in all three divisions.

SALE AND LEASEBACK TRANSACTIONS

A key element of CAE's finance strategy to support the investment in its Civil training business is the sale and leaseback of certain of the FFS installed in the Company's global network of training centres. This provides CAE with a cost-effective long-term source of fixed-cost financing. A sale and leaseback transaction can only be executed after the FFS has achieved certification by regulatory authorities (i.e., the FFS is installed and is available to customers for training). Prior to completing a sale and leaseback transaction, CAE records the cost to manufacture the FFS as a capital expenditure, which is included as a fixed asset on the Company's balance sheet. On the execution of a sale and leaseback transaction, CAE records the transaction as a disposal of a fixed asset. The cash proceeds received on the disposal approximate the fair market value of the FFS. The difference between the proceeds received and CAE's cost to manufacture, approximately the margin CAE would record if it had a competed FFS sale to a third party, is recorded under long-term liabilities and recognized into earnings as applicable. This amount, after deducting the guaranteed residual value where appropriate, is then amortized over the term of the sale and leaseback transaction as a reduction of rental expense. At the end of the term of the sale and leaseback transaction, the guaranteed residual value will be taken into income should no reduction occur in the value of the underlying simulators.

The following is a summary at March 31, 2004, of the existing sale and leaseback transactions for simulators currently in service in Civil's training locations, accounted for as operating leases on CAE's financial statements:

SALE AND LEASEBACK TRANSACTIONS — CIVIL

(amounts in millions of Canadian dollars)	Fiscal Year	Number of Simulators	Lease Obligation	Initial Term (Years)	Imputed Interest Rate	Unamortized Deferred Gain	Residual Value Guarantee
SimuFlite	2002/03	6	$ 76.5	12	5.6%	$ 2.2	—
SimuFlite	2004	5	122.1	20	5.5%	5.6	—
Toronto Training Centre	2002	2	48.7	21	6.4%	17.3	$ 9.2
Air Canada Training Centre	2000	2	38.2	20	7.6%	15.3	8.3
Denver/Dallas Training Centers	2003	5	100.8	20	5.0%	34.5	—
Amsterdam Training Centre	2002	3	29.2	8	6.4%/9.8%	—	—
China Southern Joint Venture[1]	2003	5	26.5	15	3.0%	—	—
Others	—	7	37.3	10	3.2%[2]/7.3%/10.1%	15.6	15.6
		35	$ 479.3			$ 90.5	$ 33.1
Annual lease payments (upcoming 12 months)			$ 45.0				

1 Joint venture in which CAE has a 49% interest.

2 Floating rate basis.

Future minimum lease payments for such arrangements, amounting to approximately $479.3 million as at March 31, 2004, are included in note 19 "Operating Lease Commitments" to the consolidated financial statements.

NON-RECOURSE PROJECT FINANCING

During 1997, the Company arranged project financing for the Medium Support Helicopter (MSH) program it entered into with the UK Ministry of Defence. The contract was awarded to a consortium, CAE Aircrew Training Plc (Aircrew). The capital value of the assets supplied by Aircrew is in excess of $200.0 million. The entity that owns the assets operated by the training centre is CVS Leasing Ltd. (in which CAE has a 14% interest). CAE manufactured and sold the simulators to CVS Leasing Ltd., and CVS Leasing Ltd. then leased this equipment to Aircrew for the full term of the MSH contract. As Aircrew is majority-controlled by CAE, its financial statements are consolidated in the Company's results. Future minimum lease payments associated with the simulators leased to Aircrew amount to approximately $230.3 million as at March 31, 2004, and are included in the amount disclosed in note 19 "Operating Lease Commitments" to the audited consolidated financial statements as well as in the operating leases presented as contractual obligations in the liquidity section herein.

FOURTH QUARTER

EBIT

Consolidated EBIT for the fourth quarter amounted to $27.1 million, compared to $60.5 million for the same period the previous year. The decline was attributable to a substantially lower contribution from Civil, which saw a quarter-over-quarter drop in its EBIT of $17.5 million to $12.0 million in the fourth quarter. Military realized a 26% increase in EBIT this quarter versus the third quarter. However, on a year-over-year basis the Military EBIT was down 28% to $15.9 million. The decreases from Civil and Military were slightly offset by Marine, which reported a 3% increase in its EBIT over the prior year to reach $9.2 million.

On a consolidated basis EBIT before restructuring charges of $10.0 million was $37.1 million, down 39% compared to the same period in the previous year. Restructuring charges consist of severance and other involuntary termination costs. The costs relate mainly to the workforce reduction in the Montreal plant of approximately 250 employees, following the Canadian government decision to attribute the CF-18 ADCTS simulation equipment contract to a competitor.

REVENUES

Consolidated revenue for the fourth quarter decreased by 4% to $299.3 million compared to the same period last year. On a segmented basis Military saw a 6% increase, attributed to higher activity from support services, certain land-based programs in Germany as well as the Gesi system program for the Italian Ministry of Defence. Civil's segmented revenue for the fourth quarter amounted to $128.9 million down from $137.7 million for the same period last year. Civil's decline was attributable to the adverse market conditions resulting in much lower equipment sales offset partially by higher training revenue. Marine's fourth quarter revenues dropped to $39.2 million from $50.7 million due to the impact of a contribution of $8.0 million on the completion of the Frigate 124 program in Germany last year.

CASH FLOW

Cash and short-term investments balances at the end of the fourth quarter amounted to $61.9 million, a decrease of $28.5 million compared to the third quarter, while the long-term debt, including the current portion, decreased by $49.3 million to $636.9 million resulting in $25.6 million negative cash flow for the quarter. Free cash flow (net cash provided by continuing operating activities less capital expenditures and dividends paid) for the quarter amounted to $54.3 million, up $105.8 million compared to the third quarter.

BACKLOG

Backlog for comparison purposes has been restated. For detailed discussion on the issues regarding the restatement see Civil's section of this MD&A. CAE's consolidated backlog as at March 31, 2004, was $2.9 billion, $107.9 million higher than the previous quarter.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of the contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses for the period reported. Estimates are based upon historical experience and various other assumptions that are believed to be reasonable under the circumstances. These estimates are evaluated periodically and form the basis for making judgments regarding the carrying values of assets and liabilities and the reported amount of revenue and expenses. Actual results may differ from these estimates under different assumptions.

CAE's critical accounting policies are those that it believes are the most important in determining its financial condition and results, and require significant subjective judgment by management. The Company considers an accounting estimate to be critical if the estimate requires management to make assumptions about matters that were highly uncertain at the time the estimate was made, if different estimates could have been reasonably used or if changes in the estimate that would have a material impact on CAE's financial condition or results of operations are likely to occur from period to period. A summary of the Company's significant accounting policies, including the critical accounting policies discussed below, is set out in the notes to the consolidated financial statements.

REVENUE RECOGNITION

CAE generates a significant portion of its revenue from long-term contracts in all of its three business segments. Revenue from long-term contracts is recognized using the percentage-of-completion method, where revenue, earnings and unbilled accounts receivable are recorded as related costs are incurred, on the basis of percentage costs incurred to date on a contract, relative to the anticipated total costs of completing the contract. The long-term nature of contracts involves considerable use of judgment and estimates in determining total costs and percentage of completion, as there are potential variances in scheduling, cost of materials, labour costs and productivity, and the impact of change orders that have to be considered.

The Company conducts quarterly reviews of its total estimated costs on long-term contracts. The effect of any revision is accounted for by way of a cumulative catch-up in the period in which the revision takes place. Losses on contracts, if any, are recognized fully when first anticipated. Generally, the terms of long-term contracts provide for progress billing based on completion of certain phases of work. Warranty provisions are recorded at the time revenue is recognized, based on past experience.

With the focus of the Civil business on training, the number and amount of long-term contracts is down considerably from prior years. The cost of an FFS is very predictable, particularly for repeat or common simulator types such as an A320 or B737. No revenue is recorded for FFSs built for CAE's own training centres. This cost is reflected as a capital expenditure. Revenue derived from training is recorded when the training event occurs.

For Military, full flight mission simulators are more complex and the time to design and manufacture is at least two years. There are fewer repeat orders and the level of non-recurring cost in each simulator could be significant, making the predictability of total costs more difficult when compared to a Civil FFS.

Marine contracts are also longer term in nature, usually multi-year, as the majority of the contracts are for real-time control systems requiring installation during the shipbuilding period. Most naval contracts involve supply of control systems for multiple ships of the same design with non-recurring effort for software engineering for first of class ship. The repeat ships are largely hardware with little software.

VALUATION OF GOODWILL AND INTANGIBLE ASSETS

Goodwill is no longer amortized, but is instead subject to an annual assessment, or more frequently if events or circumstances indicate, of impairment by applying a fair value based test at the reporting unit level, which for CAE are Civil, Military and Marine. An impairment loss would be recognized to the extent that the carrying amount of goodwill for each reporting unit exceeds its estimated fair market value.

The fair market values of the reporting units are derived from certain valuation models, which may consider various factors such as normalized and estimated future earnings, price earnings multiples, terminal values and discount rates. Management uses judgment to estimate the fair market value of the reporting units, and changes in estimates can affect the value of the reported goodwill. The Company performs the annual review of goodwill as at December 31 of each year, and based on the impairment test performed as at December 31, 2003, CAE concluded that no goodwill impairment charge was required.

CAE accounts for its business combinations under the purchase method of accounting, which requires that the total cost of an acquisition be allocated to the underlying net assets based on their respective estimated fair values. Part of this allocation process requires that the Company identify and attribute values and estimated lives to the intangible assets acquired. These determinations involve considerable judgment, and often involve the use of significant estimates and assumptions, including those with respect to future cash flows, discount rates and asset lives. These determinations subsequently affect the amount of amortization expense to be recognized in future periods, over the intangible assets' estimated useful lives.

DEFERRED DEVELOPMENT COSTS

Where CAE intends to produce or market a product under development that is clearly defined, has identifiable costs, is technically feasible, and has a clearly defined market or use, and the Company expects to have the financial resources to complete the project, the costs associated with the project are deferred to the extent their recovery through future sales or use of the product is reasonably assured. This requires CAE to make judgments about the likelihood of recovery of the costs. If the Company determines that recovery of the costs through future sales or use is no longer likely, deferred costs are charged against earnings in the period in which it becomes likely that the costs will not be recovered. Once the project is complete, CAE amortizes the deferred costs by reference to sales or use of the product over a period not to exceed five years (refer to note 9 of the audited consolidated financial statements).

PRE-OPERATING COSTS

The Company defers expenditures incurred during the pre-operating period for all new training centres. Expenditures directly related to placing a new training centre into commercial service are incremental in nature and are considered by management to be recoverable from the future operations of the new training centre. Capitalization ceases at the opening of the training centre. Amortization of the deferred costs is taken over five years in respect to Civil training operations and Marine operations, and over 20 years for the Military Medium Support Helicopter project, matching the term of the contract (refer to note 9 of the audited consolidated financial statements).

PENSION PLAN BENEFITS

CAE's obligations and expenses relating to pension benefits are determined using actuarial valuations, and are dependent on significant weighted average assumptions such as the long-term rate of return on plan assets, the discount rate for pension benefits obligations and the rate of compensation increase, as determined by management. While management believes these assumptions are reasonable, differences in actual results or changes in assumptions could have an impact on the obligations and expenses recorded by the Company. In accordance with GAAP, actual results that differ from the assumptions are accumulated and amortized over future periods, and generally impact the obligations and expenses for future periods (refer to note 20 of the audited consolidated financial statements).

INCOME TAXES

CAE recognizes future income tax assets, resulting mainly from losses carryforward and deductible temporary differences. Management assesses the realization of these future tax assets regularly to determine whether a valuation allowance is required. Based on evidence, both positive and negative, the Company determines whether it is more likely than not that all or a portion of the future income tax assets will be realized. The factors considered include estimated future earnings based on internal forecasts, cumulative losses in recent years, history of loss carryforward other tax assets expiring unused, as well as prudent and feasible tax planning strategies.

CHANGES IN ACCOUNTING POLICIES

During the period covered by its financial statements, CAE implemented certain changes to its accounting policies in order to conform to CICA accounting standards.

STOCK-BASED COMPENSATION

Effective April 1, 2003, CAE commenced prospectively expensing its stock-based compensation using the fair value method, as prescribed by CICA Handbook Section 3870, *Stock-based Compensation and Other Stock-based Payments*. Since that date, the compensation cost for the Company's stock options has been recognized in net earnings, with a corresponding credit to contributed surplus (refer to note 12 of the audited consolidated financial statements).

DISCLOSURE OF GUARANTEES

As at March 31, 2003, the Company adopted the CICA Accounting Guideline 14, *Disclosure of Guarantees*, which requires disclosure of information concerning certain types of guarantees that may require payments, contingent on specified types of future events (refer to note 13 of the audited consolidated financial statements).

IMPAIRMENT OF LONG-LIVED ASSETS

On April 1, 2003, the Company adopted CICA Handbook Section 3063, *Impairment of Long-Lived Assets,* which requires the recognition of an impairment loss for a long-lived asset to be held and used when events or changes in circumstances cause its carrying value to exceed the total undiscounted cash flows expected from its use and eventual disposition. An impairment loss, if any, is determined as the excess of the carrying value of the asset over its fair value. It replaces the impairment provision in Section 3061, *Property, Plant and Equipment*. The adoption of this standard did not have a material effect on consolidated financial statements.

DISPOSAL OF LONG-LIVED ASSETS AND DISCONTINUED OPERATIONS

On April 1, 2003, the Company adopted CICA Handbook Section 3475, *Disposal of Long-Lived Assets and Discontinued Operations* , which provides guidance on recognizing, measuring, presenting and disclosing long-lived assets to be disposed of. It replaces the disposal provisions in Section 3061, *Property, Plant and Equipment*, and supersedes the former Section 3475, *Discontinued Operations*. Under this section, an asset classified as held for sale is measured at lower of its carrying amount or fair value less disposal costs, and is not depreciated while classified as held for sale. The adoption of this standard did not have any material effect on CAE's consolidated financial statements.

SEVERANCE, TERMINATION BENEFITS AND COSTS ASSOCIATED WITH EXIT AND DISPOSAL ACTIVITIES

The Company prospectively adopted the new CICA Emerging Issues Committee Abstract 134 (EIC-134)

Accounting for Severance and Termination Benefits and EIC-135 *Accounting for Costs Associated with Exit and Disposal Activities (Including Costs Incurred in a Restructuring)* relating to exit or disposal activities after March 31, 2003. These abstracts provide guidance on the timing of recognition and measurement of liabilities as well as disclosures for the various types of severance and termination benefits related to the termination of employees' services prior to normal retirement and costs associated with an exit or disposal activity. Under this new guidance, liabilities for these costs are to be recognized in the period when they are incurred and measured at their fair value. CAE applied these guidelines in EIC-134 for severance and other costs (as described in note 23 of the audited consolidated financial statements).

ACCOUNTING STANDARDS NOT YET IMPLEMENTED

HEDGING RELATIONSHIPS

The CICA amended in November 2002 and June 2003 its Accounting Guideline (AcG-13), *Hedging Relationships*. It provides the views of the Accounting Standards Board on the identification, designation, documentation and effectiveness of hedging relationships for the purpose of applying hedge accounting, and the discontinuance of hedge accounting. Under this guideline, complete documentation of the information related to hedging relationships is required and the effectiveness of the hedges must be demonstrated and documented.

This new Section is applicable for the Company as at April 1, 2004. CAE's hedging relationships are documented according to related foreign exchange transactions, which in turn are continuously monitored to ensure effectiveness, and as such the adoption of this new recommendation is not expected to have a material impact on the Company's financial statements.

REVENUE RECOGNITION

In December 2003, the Emerging Issues Committee issued EIC-141, *Revenue Recognition*, summarizing the principles set forth in Staff Accounting Bulletin 101 (SAB 101) of the United States Securities and Exchange Commission and providing general interpretive guidance on the application of revenue recognition accounting principles. These recommendations are effective for CAE's fiscal year beginning April 1, 2004. The Company is not expecting the new recommendations to have a material impact on its consolidated financial statements.

REVENUE ARRANGEMENTS WITH MULTIPLE DELIVERABLES

Also in December 2003, EIC-142, *Revenue Arrangements with Multiple Deliverables,* was issued. EIC-142 addresses certain aspects of the accounting by a vendor for arrangements under which multiple revenue-generating activities will be performed. These recommendations are effective for CAE's fiscal year beginning April 1, 2004. The Company is currently assessing the impact of the new recommendations on its consolidated financial statements.

CONSOLIDATION OF VARIABLE INTEREST ENTITIES

In March 2004, the CICA issued a draft guideline of proposed amendments to its Accounting Guideline (AcG-15) titled *Consolidation of Variable Interest Entities*. The resulting guideline will be harmonized with the recently issued US guidance (FIN 46R) (see note 24 of the audited consolidated financial statements), and will be applicable for interim and annual periods beginning on or after November 1, 2004.

This guideline requires that an enterprise holding other than a voting interest in a Variable Interest Entity (VIE) could, subject to certain conditions, be required to consolidate the VIE if it is considered its primary beneficiary whereby it would absorb the majority of the VIE's expected losses and/or receive the majority of its expected residual returns. In other words, it establishes the consolidation criteria for VIEs based on a risks-and-rewards model rather than on a control-based model.

The Company is currently evaluating the impact of this new guideline on its financial statements. It is anticipated that unless certain existing agreements are modified prior to the application of this standard, CAE may be required to consolidate certain assets previously sold to special-purpose entities and the related liabilities and non-controlling interests.

FINANCIAL INSTRUMENTS

The CICA issued revisions to Section 3860 of the CICA Handbook, *Financial instruments — Disclosure and Presentation*. The Section now clarifies how to account for certain financial instruments that have liability characteristics as well as equity characteristics. It requires instruments that meet specific criteria to be classified as liabilities in the balance sheet. Many of these financial instruments were previously classified as equities. CAE does not currently have any instruments with these characteristics. Adopting this Section did not affect the Company's future consolidated financial statements.

EMPLOYEE FUTURE BENEFITS

In December 2003, new disclosure requirements for pensions and other employee future benefits were issued. The new disclosures include a narrative description of each type of plan, the measurement date of the plan asset and liability, the effective date of the last actuarial evaluation, the detail of the plan asset by major category, etc. This requirement will be applicable for CAE in the first quarter of fiscal 2005. However, as part of its ongoing disclosure, the Company already includes most of this information in its note disclosure.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND FINANCIAL STATEMENT PRESENTATION

The CICA issued new Handbook Sections 1100, *Generally Accepted Accounting Principles,* and 1400, *General Standards of Financial Statement Presentation*. Section 1100 describes what constitutes Canadian GAAP and its sources, and provides guidance on sources to consult when selecting accounting policies and appropriate disclosure when a matter is not dealt with explicitly in the primary sources of GAAP, thereby recodifying the Canadian GAAP hierarchy. Section 1400 clarifies what is fair presentation in accordance with GAAP and provides general guidance on financial presentation.

The Company does not expect any significant impact on its consolidated financial statements with the adoption on April 1, 2004, of this new Section.

FINANCIAL INSTRUMENTS

The Company enters into forward, swap and option contracts to manage its exposure to fluctuations in foreign exchange rates, interest rates, and changes in share price. CAE assesses on an ongoing basis whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. The Company does not hold or issue derivative financial instruments for speculative trading purposes. CAE deals only with sound counterparties in executing any of its derivative financial instruments.

CAE employs foreign exchange forward contracts to manage exposures created when sales are made in foreign currencies. The amount and timing of the maturity of these forward contracts varies based on a number of project related factors, including milestone billings and the use of foreign materials and/or subcontractors. As at March 31, 2004, CAE had $210.9 million Canadian equivalent in forward contracts compared to $102.9 million Canadian equivalent in forward contracts as at March 31, 2003. During the year CAE reviewed its foreign currency risk management policies and procedures while preparing for the April 1, 2004 implementation of the CICA Accounting Guideline on Hedging Relationships, and CAE's hedging strategy evolved from primarily hedging on a net foreign currency cash flow basis to more specific contract hedging. The total unrealized gain as of March 31, 2004 is $1.6 million compared to $2.7 million as of March 31, 2003.

CAE also uses financial instruments to manage its exposure to changing interest rates and to adjust its mix of fixed and floating interest rate debt at a desirable level. The mix of fixed-rate versus floating-rate debt on its long-term debt was 45%-55% respectively as at March 31, 2004. Part of the change in that mix since March 31, 2003, where it stood at 38%-62% respectively, is due mainly to the reduction in utilization of the committed bank facilities where the borrowings are all at floating rates. CAE had interest rate swaps converting mostly floating-rate long-term debt into fixed-rate term debt totalling $114.6 million which if marked to market at that date would result in a loss of $2.6 million compared to a loss of $10.3 million as of March 31, 2003.

As well, CAE reduces its exposure to the fluctuation in its share price, which impacts the cost of the DSU program. In March 2004, the Company entered into a hedging contract to reduce its cash and earnings exposure to the fluctuation in the Company's share price relating to the DSU program. As at March 31, 2004, the hedging contract covered 700,000 shares of the Company.

DISCLOSURE OF OUTSTANDING SHARE DATA

CAE's articles of incorporation authorize the issuance of an unlimited number of common shares, and an unlimited number of preferred shares, issuable in series. To date, the Company has not issued any preferred shares. At March 31, 2004, CAE had 246,649,180 common shares issued and outstanding. As at the same date, the Company had 8,128,370 options outstanding, of which 2,887,000 were exercisable.

SYSTEMS, PROCEDURES AND CONTROLS

CAE management is responsible for establishing appropriate information systems, procedures and controls to ensure that all financial information disclosed externally, including this MD&A, and used internally by management, is complete and reliable. These procedures include a review of the financial statements and associated information, including this MD&A, by the Audit Committee of the Board of Directors. The Company's Chief Executive Officer and Chief Financial Officer have a process to evaluate the applicable systems, procedures and controls and are satisfied they are adequate for ensuring that complete and reliable financial information is produced.

QuickLinks

Exhibit 3

MANAGEMENT'S DISCUSSION AND ANALYSIS

Exhibit 4

PricewaterhouseCoopers LLP
Chartered Accountants
1250 René-Lévesque Boulevard West
Suite 2800
Montreal, Quebec
Canada H3B 2G4
Telephone +1 (514) 205 5000
Facsimile +1 (514) 205-5675

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the use in this Annual Report on Form 40-F of CAE Inc. for the year ended March 31, 2004, of our auditors' report dated May 11, 2004 on the consolidated balance sheets of CAE Inc. as at March 31, 2004 and 2003 and the consolidated statements of earnings, retained earnings and cash flows for each of the years in the three-year period ended March 31, 2004, and our related Comments by Auditor for U.S. Readers on Canada-U.S. Reporting Difference dated May 11, 2004.

We also consent to the incorporation by reference in the Registration Statement on Form S-8 (No. 333-97185) of CAE Inc., relating to common shares to be offered to employees under employee benefit plans, of our auditors' report dated May 11, 2004 relating to the above-mentioned financial statements and of our related Comments by Auditors for U.S. Readers on Canada-U.S. Reporting Differences dated May 11, 2004.

/s/ PricewaterhouseCoopers LLP
Chartered Accountants

Montreal, Quebec
August 11, 2004

PricewaterhouseCoopers refers to the Canadian firm of PricewaterhouseCoopers LLP and other members of the worldwide PricewaterhouseCoopers organization.

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Exhibit 5

**CERTIFICATION REQUIRED BY RULE 13a-14(a) OR RULE 15d-14(a),
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, D.H. Burney, President and Chief Executive Officer of CAE Inc., certify that:

1. I have reviewed this annual report on Form 40-F of CAE Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this report;

4. The issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the issuer and have:

   (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) evaluated the effectiveness of the issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) disclosed in this report any change in the issuer's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting; and

5. The issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the issuer's auditors and the audit committee of the issuer's board of directors (or persons performing the equivalent functions):

   (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the issuer's ability to record, process, summarize and report financial information; and

   (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal control over financial reporting.

Date: August 11, 2004

/s/ D.H. BURNEY

Name: D.H. Burney
Title: President and Chief Executive Officer

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Exhibit 5

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Exhibit 6

**CERTIFICATION REQUIRED BY RULE 13a-14(a) OR RULE 15d-14(a),
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Paul G. Renaud, Executive Vice President Chief Financial Officer of CAE Inc., certify that:

1. I have reviewed this annual report on Form 40-F of CAE Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this report;

4. The issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the issuer and have:

   (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) evaluated the effectiveness of the issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) disclosed in this report any change in the issuer's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting; and

5. The issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the issuer's auditors and the audit committee of the issuer's board of directors (or persons performing the equivalent functions):

   (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the issuer's ability to record, process, summarize and report financial information; and

   (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal control over financial reporting.

Date: August 11, 2004

/s/ PAUL G. RENAUD

Name: Paul G. Renaud
Title: Executive Vice President,
Chief Financial Officer and Secretary

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Exhibit 6

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Exhibit 7

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ENACTED PURSUANT TO
SECTION 906 OF THE U.S. SARBANES-OXLEY ACT OF 2002**

CAE Inc. (the "Company") is filing with the U.S. Securities and Exchange Commission on the date hereof, its annual report on Form 40-F for the fiscal year ended March 31, 2004 (the "Report").

I, D.H. Burney, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. section 1350, as enacted pursuant to section 906 of the U.S. Sarbanes-Oxley Act of 2002, that:

(i) the Report fully complies with the requirements of section 13(a) or 15(d) of the U.S. Securities Exchange Act of 1934; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to CAE Inc. and will be retained by CAE Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

/s/ D.H. BURNEY

D.H. Burney
President and Chief Executive Officer

Date: August 11, 2004

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Exhibit 7

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Exhibit 8

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ENACTED PURSUANT TO
SECTION 906 OF THE U.S. SARBANES-OXLEY ACT OF 2002**

CAE Inc. (the "Company") is filing with the U.S. Securities and Exchange Commission on the date hereof, its annual report on Form 40-F for the fiscal year ended March 31, 2004 (the "Report").

I, Paul G. Renaud, Executive Vice President, Chief Financial Officer and Secretary of the Company, certify, pursuant to 18 U.S.C. section 1350, as enacted pursuant to section 906 of the U.S. Sarbanes-Oxley Act of 2002, that:

(i) the Report fully complies with the requirements of section 13(a) or 15(d) of the U.S. Securities Exchange Act of 1934; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to CAE Inc. and will be retained by CAE Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

/s/ PAUL G. RENAUD

Paul G. Renaud
Executive Vice President,
Chief Financial Officer and Secretary

Date: August 11, 2004

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Exhibit 8