UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 40-F

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

For fiscal year ended: March 31, 2007 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)*

8585 Côte-de-Liesse, Saint-Laurent, Québec, H4T 1G6

514-341-6780

(*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:

þAnnual Information Form þAudited 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: **251,960,449**

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 ¨ No þ

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 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 þ No ¨

DISCLOSURE CONTROLS AND PROCEDURES

A. Evaluation of disclosure controls and procedures. Disclosure controls and procedures are designed to ensure that information required to be disclosed by CAE Inc. ("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 President and Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding disclosure.

Under the supervision of the President and Chief Executive Officer and Chief Financial Officer, management evaluated the effectiveness of CAE's disclosure controls and procedures, as defined in Rule 13a-15(e) and 15d-15(e) under the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of March 31, 2007. The President and Chief Executive Officer and the Chief Financial Officer concluded from the evaluation that the design and operation of CAE's disclosure controls and procedures were effective as at March 31, 2007.

*B. Management's annual report on internal control over financial reporting.*CAE's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act.

CAE's internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of CAE's assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that CAE's receipts and expenditures are being made only in accordance with authorizations of its management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of CAE's assets that could have a material effect on the financial statements.

Management evaluated the effectiveness of CAE's internal controls over financial reporting as of March 31, 2007, based on the framework and criteria set forth in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and has concluded that CAE's internal control over financial reporting is effective as of the end of the period covered by this annual report.

*C. Attestation report of the registered public accounting firm.*PricewaterhouseCoopers LLP, an independent registered public accounting firm, who audited and reported on CAE's financial statements included in this annual report, has issued an attestation report on management's assessment of CAE's internal control over financial reporting as of the end of the period covered by this annual report. This attestation report is attached as Exhibit 5 to this annual report.

*D. Changes in internal control over financial reporting.*CAE implemented the first phase of its new ERP system in the TS/C segment with the intention, amongst other things, of improving internal controls.

With the exception of the above mentioned, there were no other changes to CAE's internal control over financial reporting during the year ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, CAE's internal control over financial reporting.

*E. Limitations on the effectiveness of controls.*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 President and Chief Executive Officer and our Chief Financial Officer, does not expect that CAE's internal control over financial reporting will prevent or detect all error and all fraud.

CAE will continue to periodically review its disclosure controls and procedures and internal control over financial reporting and may make modifications from time to time as considered necessary or desirable.

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 (the "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 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 CAE’s website. Unless specifically referred to herein, the information on CAE’s website shall not be deemed to be incorporated by reference in this annual report.

PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following PricewaterhouseCoopers LLP aggregate fees were billed to CAE in each of the years ended March 31, 2007 and 2006 for professional services rendered to CAE:

Fees		2007	2006
		(amounts in CAD$ millions)	
Audit Fees[1]	$	3.6$	2.3
Audit-Related Fees[2]		0.4	0.3
Tax Fees[3]		0.8	0.6
Total	$	4.8$	3.2

[1] Audit fees are comprised of fees billed for professional services for the audit of CAE’s annual financial statements and services that are normally provided by PricewaterhouseCoopers LLP in connection with statutory and regulatory filings, including the audit of the internal controls over financial reporting as required by the Sarbanes-Oxley Act of 2002.

[2] Audit-related fees are comprised of fees relating to work performed in connection with CAE’s divestitures

[3] Tax fees are related to tax compliance support

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 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. None of the services described above under the captions “Audit-Related Fees” or “Tax Fees” were approved by the Audit Committee pursuant to paragraph (c)(7)(i)(C) of Rule 2-01 of Regulation S-X.

OFF-BALANCE SHEET ARRANGEMENTS

The disclosure provided under section 7.3 “Off-Balance Sheet Arrangements” on page 58 of Exhibit 3, Management’s Discussion and Analysis, is incorporated by reference herein.

CONTRACTUAL OBLIGATIONS

The disclosure provided under section 6.3 “Contractual Obligations” on page 55 of Exhibit 3, Management’s Discussion and Analysis, is incorporated by reference herein.

IDENTIFICATION OF THE AUDIT COMMITTEE

CAE has a separately-designated standing Audit Committee established in accordance with Section 3(a)(58)(A) of the Exchange Act. CAE’s Audit Committee is, as of the date hereof, comprised of the following directors: John A. Craig, Paul Gagné, James F. Hankinson and Katharine Stevenson.

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 Commission staff, and to furnish promptly, when requested to do so by the Commission staff, information relating to: the securities in relation to which 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 Commission 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:

CAE INC.

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

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EXHIBIT INDEX

Exhibit No.	Description
1	Annual Information Form dated June 27, 2007
2	Audited annual financial statements for the fiscal year ended March 31, 2007
3	Management's Discussion and Analysis for the year ended March 31, 2007
4	Consent of PricewaterhouseCoopers LLP
5	Independent Auditors' Report of PricewaterhouseCoopers LLP
6	Certificate of Robert E. Brown required by Rule 13a-14(a) or Rule 15d-14(a)
7	Certificate of Alain Raquepas required by Rule 13a-14(a) or Rule 15d-14(a)
8	Certificate of Robert E. Brown pursuant to 18 U.S.C. Section 1350, as enacted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
9	Certificate of Alain Raquepas pursuant to 18 U.S.C. Section 1350, as enacted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
10	Notice and Proxy Informational Circular dated May 31, 2007 (incorporated by reference to CAE's Form 6-K (commission file no. 1-31402) furnished to the Commission on June 13, 2007

2007
ANNUAL INFORMATION FORM
(Fiscal Year Ending March 31, 2007)

CORPORATE OFFICE
8585 Chemin Côte-de-Liesse
Saint-Laurent, Québec
Canada H4T 1G6

June 27, 2007

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INFORMATION INCORPORATED BY REFERENCE

The Company's Management's Discussion and Analysis and its consolidated financial statements for the year ended March 31, 2007, and the notes thereto (Consolidated Financial Statements) appear on pages 28 to 73 and pages 74 to 130 respectively in the Annual Report to Shareholders for the year ended March 31, 2007 (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 28 to the Consolidated Financial Statements. The information contained therein is specifically incorporated by reference into this Annual Information Form (AIF). Any parts of the Annual Report not specifically incorporated by reference do not form part of this AIF.

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

References to fiscal 2007 refer to the period from April 1, 2006 to March 31, 2007, references to fiscal 2006 refer to the period

from April 1, 2005 to March 31, 2006, and references to fiscal 2005 refer to the period from April 1, 2004 to March 31, 2005.

This Annual Information Form contains forward-looking statements with respect to CAE and its subsidiaries based on assumptions which CAE considered reasonable at the time they were prepared and may include information concerning the Company's markets, future financial performance, business strategy, plans, goals and objectives. These forward-looking statements, by their nature, necessarily involve risks and uncertainties that could cause actual results to differ sometimes materially from those contemplated by the forward-looking statements. Statements preceded by the word "believe", "expect", "anticipate", "intend", "continue", "estimate", "may", "will", "should" and/or similar expressions are forward-looking statements. CAE cautions the reader that the assumptions regarding future events, many of which are beyond the control of CAE, may affect the extent to which a particular projection materializes and/or could ultimately prove to be incorrect; accordingly, readers are cautioned not to place undue reliance on these forward-looking statements. Factors that could cause actual results or events to differ materially from current expectations are discussed in the section "Risk Factors" herein. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by law or regulation. In particular, forward-looking statements do not reflect the potential impact of any merger, acquisition or other business combinations or divestitures that may be announced or completed after such statements are made.

1. CORPORATE STRUCTURE OF CAE

1.1 Name, Address and Incorporation

On March 17, 1947 CAE Inc. (Company or CAE) was incorporated under the name Canadian Aviation Electronics Ltd. under the laws of Canada by letters patent. In 1965, the name of the Company was changed to CAE Industries Ltd. and in 1993 the Company changed its name to its present one, CAE Inc.

The Company was continued in 1977 under the Canada Business Corporations Act (CBCA) by certificate of continuance. In 1979, the articles of the Company were amended to change its authorized share capital to an unlimited number of common shares. In 1981, the Company's articles were again amended 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.

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 amalgamated with CAE Electronics Ltd., its wholly-owned subsidiary.

The Company's registered office is located at 8585 Côte-de-Liesse, Saint-Laurent, Québec, Canada H4T 1G6, telephone: (514) 341-6780, fax: (514) 340-5530.

1.2 Inter-corporate Relationships

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

2. GENERAL DEVELOPMENT OF THE BUSINESS

2.1(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 defence requirements. A few years later, CAE began its commercial flight simulation activities.

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

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

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

CAE has built an excellent reputation and long-standing customer relationships based on 60 years of experience, strong technical capabilities, a highly trained workforce and global reach. About 5,500 employees work full-time in production and training facilities in 19 countries

around the world. Approximately 90% of CAE's annual revenues come from worldwide exports and international activities.

2.1(b) History

Over the past three fiscal years, CAE made one divestiture to better focus on its core businesses. CAE completed the divestiture of substantially the entire Marine Controls segment to L-3 Communications (L-3) of New York, NY during the fourth quarter of fiscal 2005 in a transaction valued at $239 million, resulting in an after-tax gain of approximately $104 million. In accordance with the purchase agreement, L-3 subsequently acquired two other components of the Marine Controls segment, including the assumption of CAE's guarantee of $53 million (£23 million) of project-finance related debt for the UK Astute Class submarine training program, following all required approvals being obtained.

In a reorganization of management responsibilities announced on May 22, 2006, sales and marketing of military simulation equipment, training and services were brought under the newly named Simulation Products and Military Training & Services Group led by Marc Parent, Group President. The most important priorities of SP/C and SP/M are lowering manufacturing costs, shortening manufacturing cycle times, and developing efficient and innovative technologies to further improve simulation products.

In addition, CAE formed an Innovations Group under the direction of Jeff Roberts, Group President, also responsible for the TS/C segment. A core group of people have been exploring different opportunities to build on our key strengths and tap new, emerging and adjacent markets to invest in during the year. Opportunities to leverage on our core competencies are being focused at six areas: medical simulation, transportation, aviation services, games and entertainment, and aviation equipment.

CAE is investing in software and hardware innovations that are intended to sustain its leading-edge technologies as well as complement its training services for CAE training centres and other customers. Examples of such innovation are the new CAE 5000 series of full flight simulators, new generation CAE Simfinity® suite of flight training devices and desktop trainers, CAE Tropos-6000® and CAE Medallion™-6000 image generators and CAE True^{TM} electric motion system.

CAE has continued its investment in pilot training, and its increased access to the US and European military markets, during the past three years. In addition to acquisitions, CAE's move into civil training and services was further accelerated during that period with the following training centre initiatives by TS/C:

- In April 2004, CAE acquired LAN's training facility in Santiago, Chile and commenced providing flight training to LAN's pilots under a 10-year services agreement. Since the acquisition, CAE has added an A320 and a B767-300 bringing the total to 3 FFS.
- CAE and Iberia Lineas Aereas de Espana, SA (Iberia) formed 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. Iberia trains its approximately 2,000 pilots at the joint venture training centre, which also attracts a lot of third party training. CAE has

80% of the equity of the joint venture company. In 2006, CAE expanded the Barajas facility and closed the original Alcala facility. The current operation comprises 11 FFS in Barajas.

- CAE in August, 2005 signed a ten year agreement with UK-based Virgin Atlantic Airways to provide training for pilots of the carrier's entire fleet of Airbus A340-600 and Boeing 747-400 aircraft. In addition to this contract, the continued growth of easyJet and the Dassault programs support further growth in Burgess Hill. CAE is in the final stages of a second expansion bringing the total number of bays to twelve. In December of 2006, CAE commenced training on the Dassault 900EX EASy and 2000EX EASy, and in mid 2007, training will begin on the 7X. The Burgess Hill facility currently operates eight FFS with the remaining four bays to be used to support key customers.

- With demand for airline pilots growing worldwide, CAE is witnessing increasing interest in its pilot provisioning program, a turnkey service that includes a complete range of pilot recruiting and training for airlines. In addition to our base of business in Europe (Ryanair, Vueling, etc.) CAE is now delivering pilots to Indian and Chinese carriers, and is pursuing expansion into South East Asia, the Middle East and South America.

- CAE officially opened its new North East Training Centre near Morristown Airport, New Jersey, USA in June 2007. The state-of-the-art North East Training Centre is the first to offer training for the Dassault Falcon 7X, and also features training for the Falcon 900EX
  EASy, Falcon 2000EX EASy, the Gulfstream IV and the Sikorsky S76C+/B helicopter. The new centre houses six simulator bays. CAE has announced plans to expand the center from six to twelve bays to support the installation of more FFS (including the Gulfstream G450/G550 scheduled to be installed in late 2007).

- In support of continued aviation growth in China, ZFTC (CAE's joint venture with China Southern Airlines in Zhuhai, China) is expanding its operation with the construction of a new eight bay facility. The facility will be ready for training in mid-2007 and will offer A320, A330 and Boeing 777 training. This will bring the total number of CAE-built FFS that ZFTC operates to thirteen; ZFTC continues to be the largest independent flight training provider in China.

- During fiscal year 2007, CAE continued growing its global training network and finalized over 50 new business aviation agreements, many of them with Fortune 500 companies, and 20 new commercial aviation training agreements with airlines such as: Indigo Airlines, Avanti Air, Pinnacle Airlines, Air Atlanta, Air Madagascar, Skywest Airlines, and Martinair.

- A ten year joint venture was agreed with Embraer to provide training for their new light and very light jets, the Phenom 300

and 100, and work continues on finalising all relevant contracts to implement the new training company.

- In 2006, CAE launched a Services Initiative to leverage core competencies in training to provide additional services to our broader customer base. These include training center operations, maintenance technician training, and courseware creation and delivery

services. Recent examples of the progress of this initiative include service contracts with Jetblue, Etihad and FAA.

CAE has experienced numerous successes in military training and services through its SP/M and TS/M segments in recent years, including:

- CAE will lead the design and development of NH90 helicopter virtual maintenance trainers for the German Armed Forces. CAE is developing the NH90 virtual maintenance trainer (VMT) software, simulation-based maintenance training courseware, instructor operator stations and training management system. The NH90 VMTs will be based on CAE Simfinity® technology. The NH90 VMTs will include a virtual representation of all the NH90 aircraft systems so maintenance personnel can practice diagnosing and troubleshooting maintenance problems. The NH90 virtual maintenance training program is in addition to CAE's previously announced role on the German NH90 program. CAE is part of a consortium awarded a major private finance initiative (PFI) program in 2005 for the German Armed Forces NH90 training. Valued at €488 million, Helicopter Flight Training Services GmbH (HFTS), in which CAE is a 25% shareholder, will provide NH90 helicopter training in private training centres. The training centres, scheduled to open later in 2008, will be the first for the NH90. In addition, for the design and manufacture of the NH90 simulators and related training systems, CAE and Thales have partnered to serve as the prime contractor and design authority for producing the NH90 training systems. CAE is responsible for software systems such as the tactical environment, electronic warfare, communications, and weather radar. CAE is also providing the CAE Medallion™ 6000 image generator hardware, has overall responsibility for integ ration and deployment, and is managing construction of the training centres.

- CAE will design an EH101 full crew mission simulator (FCMS) for the Marina Militare Italiana (Italian Navy). The EH101 FCMS will include the full mission flight simulator (FMFS) for training EH101 pilots and the rear crew trainer (RCT) for training the rear crew in the operation of all tactical, sensor, and weapon systems in the aircraft. CAE is also performing a range of upgrades on the CAE-built UK Royal Navy's EH101 Merlin Training System under subcontract to Lockheed Martin UK. As part of the Merlin Capability Sustainment Programme (MCSP), CAE will upgrade the Merlin Cockpit Dynamic Simulator (full-mission simulator), Cockpit Procedures Trainer (CPT), and two Rear Crew Trainers (RCTs) stationed at Royal Navy Air Station (RNAS) Culdrose. CAE has strengthened its relat ionship with the European Aerospace Defence and Space (EADS) company over the past several years. CAE is under contract by EADS North America to design and manufacture the first UH-72A Lakota cockpit procedural trainer (CPT) for the United States Army. The Army plans to acquire up to 322 UH-72A helicopters over the next decade. CAE is under contract from EADS CASA and the Commonwealth of Australia to provide a turnkey training capability and five years of support services for the Royal Australian Air Force's (RAAF) new A330 Multi-Role Tanker Transport (MRTT) aircraft. CAE is also EADS CASA's preferred training provider for the C-295 tactical transport aircraft and is currently under contract to design and manufacture two C-295 full-flight simulators.

- CAE USA continues to grow its relationship with the US Army's 160th Special Operations Aviation Regiment – Airborne SOAR(A), an elite unit known as the Night Stalkers. Over the past several years, CAE USA has been awarded contracts to design

and develop a range of mission rehearsal and training systems for this customer. Included in CAE's work for this Regiment is the development of the innovative Common Environment/Common Database (CE/CDB), which is expected to significantly reduce the mission rehearsal timeline required for high-fidelity database production. The CE/CDB is included in the recently delivered MH-47G Chinook combat mission simulator, and will be part of the MH-60L Black Hawk combat mission simulator that CAE will deliver to the Regiment in 2008.

- CAE won a competitive procurement to design and manufacture MH-60R and SH-60B tactical operational flight trainers (TOFTs) for the United States Navy. Initially, CAE will develop one MH-60R TOFT and one SH-60B TOFT for these US Navy helicopters, with options for two additional MH-60R TOFTs. The first MH-60R TOFT will be delivered to Naval Station (NS) Mayport, Florida in late 2008, while the SH-60B TOFT will be delivered to Marine Corps Air Station (MCAS) Kaneohe Bay, Hawaii in 2009. A TOFT consists of two training devices – the Operational Flight Trainer (OFT) used to train the pilot and co-pilot, and the Weapons Tactics Trainer (WTT) used to train the sensor operators and rear-crew. When networked together, the OFT and WTT form the Tactical Operational Flight Trainer th at provides a total aircrew mission training solution. The MH-60R and SH-60B TOFTs will also be able to network with other Navy training assets to provide distributed mission training. CAE is also the prime contractor on the Navy's MH-60S helicopter training program. Since June 2004, the US Navy has contracted CAE to design and manufacture four MH-60S TOFTs and four MH-60S WTTs, with the first TOFT delivered on-time and declared ready-for-training at Naval Air Station Norfolk in 2006. CAE's contracts with the US Navy for MH-60S and MH-60R training systems total over C$125 million over the past three years.

- CAE USA is continuing its development on a US Army program called the SyntheticEnvironment Core – Database Virtual Environment Development. Under the SE-Core DVED effort, CAE is developing a common database architecture, rapid database production processes and tools, and establishing five database production centres locatedin the United States and around the world. These database production centres will create the Army's Common Virtual Environment (CVE), a fully integrated and correlated virtual environment that the Army will use for virtual training and mission rehearsal. The first of these database production centres is expected to open in Orlando, Florida inautumn 2007.

- Rotorsim, the consortium owned equally by CAE and AgustaWestland, a Finmeccanicacompany, officially opened for training in the summer of 2006. The first class of students performed recurrent and initial type training for the A109 Power helicopter. In addition, Rotorsim's A109 and AW139 simulators achieved Level D certification fromthe Federal Aviation Administration.

Through its SP/C segment, CAE continues to lead the market in the sales of full-flight simulators and other flight training devices. The SP/C segment continues to invest in technology to improve its product offering in terms of cost, schedule, performance, and additional features that enhance safety and efficiency. Recent developments included:

- Launching a breakthrough product, the CAE 5000 Series full-flight simulator, designedspecifically to address training requirements for high-volume commercial narrow-body aircraft such as the Boeing 737 and the Airbus A320, as well as the business jet market

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including the emerging Very Light Jets (VLJs). The 5000 Series FFS is a direct result of input from CAE's customer and technical advisory boards, CAE's own training instructors, and close coordination with regulatory agencies worldwide. Customers wanted CAE's quality, reliability and fidelity in a product that would help them be more cost efficient and address specific training requirements, including:

· initial and recurrent training on narrow-body platforms;
· business aviation training, including the emerging VLJ segment; and
· third-party training, including emerging Multi-crew Pilot License (MPL) training programs designed to address the global pilot shortage.

· Delivering the CAE True^{TM} Electric Motion System and qualifying and certifying this system on four CAE-built full-flight simulators (FFSs) to Level D, the highest performance rating for flight training equipment with the European Joint Aviation Authority (JAA) and the Japan Civil Aviation Bureau (JCAB). This is the first FFS Level D certification with electric motion for the Airbus A320 and the Boeing 737NG. The four simulators are: two Boeing 737-800s, one Airbus A320 for Flight Simulation Company (FSC), and one Boeing 737-800 for Japan Airlines. z Launching the latest addition to the CAE Tropos® family of image generators called the CAE Tropos-6000. The new CAE Tropos-6000 series combines CAE's industry-leading image quality and true fidelit y with the latest commercial-off-the-shelf (COTS) graphics hardware. In addition, the CAE Tropos-6000 image generator leverages new Liquid Crystal on Silicon (LCoS) projector technology to deliver unprecedented realism in a visual solution. CAE Tropos-6000 utilizes the latest-generation graphics processors from ATI and is available in three configurations: Tropos-6100, Tropos-6200, and Tropos- 6400. The high-end CAE Tropos-6400 is designed to meet the demanding requirements of Level D training by employing four graphics processing units (GPUs) per LCoS projector covering a field-of-view of 200° x 43° for a 3-channel configuration. The CAE

· Tropos-6200 is designed for full-flight simulators and flight training devices not requiring Level D certification and uses two GPUs per projector. The CAE Tropos-6100 is ideal for laptop or desktop applications such as airport familiarization and uses a single GPU.

2.1(c) Industry Overview and Trends

The civil and military markets CAE serves are driven by factors particular to each market. CAE believes the civil market is most affected by the nature, size and composition of aircraft fleets, aircraft delivery schedules, pilot demographics, certification requirements and market demand for commercial and business air travel. The Company believes the military market is mostly influenced by a combination of defence spending and the nature of military activity. Demand for CAE's military products and services are also influenced by the degree to which Military forces globally tend toward the outsourcing of functions to the private sector. As well, CAE's military business is expected to be impacted by the extent to which synthetic mission rehearsal solutions gain market acceptance.

Simulation Products/Civil (SP/C)

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 FAA 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, customer support, delivery, supplier reputation, price and life cycle costs. In fiscal 2007, 34 FFS were sold by CAE to third parties. Typical list prices for civil flight simulation equipment can range from up to US$1 million for sophisticated procedure trainers, from US$2 to US$5 million for a flight training device (FTD) and from US$8 to US$16 million for an FFS, assuming that OEM-supplied data, parts and equipment are included.

Training & Services/Civil (TS/C)

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, to enable maintenance workers to inspect, maintain and repair aircraft and to train cabin crews. Training is provided to commercial and regional airlines, business operators, and general aviation institutions. Today, approximately half of all training capacity around the world is 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 however, also use independent training providers 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. All business aviation training is delivered by independent training providers.

SP/C and TS/C Trends and Developments

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 FFS effective tools for training pilots and crew. Pilots and crew can be trained for a variety of aircraft, using visualizations of most of the major civil airports around the world, and in varying environmental conditions. The cost savings to aircraft operators are substantial as it is 5 to 10 times less expensive 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. Simulation training also allows pilots to experience and learn emergency procedures that cannot be practiced safely aboard an actual aircraft. FFS training users are accorded more favorable liability insurance premiums. Simulator-based training also offers considerable flexibility with respect to the timing and duration of training sessions.

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.

Simulation-based pilot certification training will begin taking on an even greater role with the new Multi-crew Pilot License (MPL) certification process and guidelines being developed by the International Civil Aviation Organization (ICAO) that will be completed later this year for consideration by the individual National Authorities. The MPL process places more emphasis on simulation-based training to develop *ab initio* students into first officers for modern airliner aircraft. MPL is expected to be widely adopted in emerging markets like China, India and Southeast Asia where there is expected to be the greatest need to produce a large supply of qualified pilots in the most efficient and effective manner.

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 to 30 wide-bodied commercial aircraft in operation, with that ratio changing to 30 for narrow-bodied commercial aircraft, 40 for regional jets and 80 for business aircraft.

New aircraft deliveries are a major driver for this market. The report "The World Market for Large Commercial Jet Transports" published by Forecast International/DMS Inc. projects that 8,184 large commercial jet transports will be produced in the coming ten years (2007-2016). During the same period, Forecast International/DMS Inc. expects about 4,000 regional aircraft to be built.

During calendar year 2006, Airbus and Boeing announced orders for 824 and 1058 aircraft respectively which, upon delivery, should have a positive impact on demand for simulators and/or training services.

CAE believes that additional demand for business aircraft simulation training will be driven by growth in new business aircraft sales, the increase in fractional ownership, and unscheduled charter flights. According to Forecast International/DMS Inc., business jet production is expected to total 12,000 units over the next ten years, of which 4,000 (or about one-third), will be Very Light Jets (VLJs) such as the Eclipse 500, the Embraer Phenom 100, and the Cessna Mustang.

Long-term growth in civil air travel is likely to drive increased aircraft deliveries across the spectrum of aviation service providers and, in turn, the demand for simulation technology and training.

Crew Member Demographics

According to latest AIR Inc. data, US pilot hiring in 2006 was for 8,256 pilots. In 2007, 8,500 pilots are expected to be hired in the US. The most active airlines in the hiring are the low-cost, nationals and regional airlines. Pilots are subject to a statutory retirement, which necessitates constant training of other pilots to replace retirees. 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. This 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. Lack of pilots, maintenance technicians and cabin crew members is even more acute in emerging markets, like China and India, where air traffic is growing at much higher rates than in developed countries and where there is even less of a pilot supply infrastructure to meet current and projected demand. For example, Boeing's flight training subsidiary Alteon Training L.L.C. is projecting that for pilots alone, in China there will be a requirement for more than 2,000 additional new pilots per year until 2025.

Simulation Products/Military (SP/M)

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 and mission rehearsal 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/maritime patrol aircraft. Flight simulators permit the crews of military aircraft to coordinate and improve their combat skills in a safe, cost-effective and

realistic range of environments. The US Air Force estimates that one hour in a simulator costs less than six minutes in an actual 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, the systems often operate in conjunction with other equipment in environments involving many soldiers and various weapons systems.

CAE remains committed to introducing new simulation products that enhance its reputation as a technology leader. A strategic priority for CAE is to continue to bring innovative products and simulation-based solutions to market. For example, CAE has developed a new and innovative Common Environment/Common Database (CE/CDB) architecture for the United States Special Operations Command (SOCOM). The CE/CDB architecture was first implemented on the MH-47G Chinook combat mission simulator that CAE recently delivered to the US Army's 160th Special Operations Aviation Regiment. The CE/CDB promises to significantly enhance mission rehearsal capabilities with rapid, correlated database features. Through the ongoing enhancement of current leading-edge technologies and the development of new simulation-based technologies, CAE aims to maintain its position as a world leader in modelling, simulation and mission rehearsal technologies for the military market.

Training & Services/Military (TS/M)

Given finite defence budgets and resources, governments and defence forces are increasingly scrutinizing their expenditures. In the area of training, outsourced or privatized training service delivery has demonstrated benefits such as cost-effectiveness and accelerated training delivery. CAE continues to see a growing willingness from defence forces to use synthetic training to meet more and more of their training requirements, as well as increasing demand to use simulation for mission rehearsal. While synthetic training will never completely replace live combat training, the Company sees more militaries increasing the number of synthetic training hours as a complement to live training. The TS/M group continues to pursue a range of training services opportunities as well as professional service opportunities.

Governments show an ever-increasing interest in the efficiencies and service enhancement potential of outsourcing aspects of

their military training and support services to the private sector. The openness of national markets to international entrants is always an issue, particularly in the sensitive field of national security. However many countries have demonstrated in recent years both a greater willingness to outsource military training and support services and to permit foreign-controlled entities to deliver such services. The multinational approach adopted by some governments to equipment development and procurement has facilitated this evolution in the market for military services.

The industry has responded to this trend by adapting to a greater degree of cooperation in product and service development and provisioning. However, competition remains very vibrant, subject to national security constraints in certain markets.

SP/M and TS/M Trends and Developments

CAE believes the following trends will influence the development of the military simulation and training market serviced by SP/M and TS/M:

Increasing Defence Spending

The fiscal 2007, national defence budget in the US is approximately US$439 billion, which does not include approximately US$93 billion in additional funding requested to support the war efforts in Iraq and Afghanistan. In fiscal 2008, the President has proposed a budget US$481 billion and another US$141 billion in supplemental funding. The US Department of Defense budget has increased over 40 percent since 2001. The US government's defence spending has recently represented close to 50% of the world's known total defence spending and this is expected to continue through this decade. Apart from spending on defence, 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 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 modelling, simulation, and synthetic 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 NH90 helicopter to provide significant simulation and training opportunities. In addition, upgrades to aircraft such as the German Tornado tactical aircraft, the German Navy's recently acquired P-3C Orion maritime patrol aircraft, and the UK Lynx helicopter fleets will create additional flight simulation requirements. In the United States, new aircraft programs such as the US Navy's P-8A Multi-mission Maritime Aircraft, the US Army's Light Utility Helicopter, the Army/Air Force Joint Cargo Aircraft, and the US Air Force's new combat search and rescue helicopter will present a range of simulation and training opportunities. In addition, Canada expects to pursue

the acquisition of new transport/airlift aircraft, heavy-lift helicopters, and fixed-wing search and rescue aircraft that will bring simulation and training opportunities that CAE will actively pursue.

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 and mission rehearsal 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 rapid development of extensive environment databases offer militaries the ability to train and rehearse in situations and conditions either difficult or impossible to consistently replicate in a physical setting. Second, simulation training also is more cost effective 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 seeks 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 offering better value for money. CAE's Medium Support Helicopter Aircrew Training Facility (MSHATF) has been in full-scale operation since 2000 as the UK's first military training PFI. The government of Germany awarded a consortium comprising CAE, Eurocopter, Rheinmetall Defence Electronics GmbH and Thales a contract to provide NH90 helicopter training services to the German Armed Forces over 14.5 years beginning in 2008. Currently, CAE and Thales are teamed to lead the design and manufacture of the NH90 simulators and related training equipment that will be used to deliver the training services.

3. DESCRIPTION OF THE BUSINESS

3.1 General

CAE is a world leading designer and manufacturer of advanced simulation equipment and provider of integrated training solutions for the military and civil aviation markets. With 60 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 and provided training services to the military forces of almost 50 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 training services based on the number of simulators in operations.

CAE has a global presence with about 5,500 full-time employees at manufacturing operations and training facilities in 19 countries around the world. The Company's consolidated revenue from continuing operations in fiscal 2006 and 2007 was $1.107 billion and $1.251 billion, respectively, and is broken down as follows:

Revenue by Product Line (%)

	2007	2006
SP/C	28	23
TS/C	27	29
SP/M	28	30
TS/M	17	18
	100	**100**

Geographic Distribution of Revenue (%)

	2007	2006
US	32	35
Germany	12	14
Canada	11	9
The Netherlands	7	9
UK	8	7
China	5	5
United Arab Emirates	4	6
Other Asian countries	6	5
Other countries	5	6
Other European countries	10	4
	100	**100**

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

Location	*SP/C*	*SP/M*	*TS/C*	*TS/M*
Canada				
Montreal, Quebec	✓	✓	✓	✓
Toronto, Ontario			✓	
Ottawa, Ontario				✓
Europe				
Amsterdam, The Netherlands			✓	
Brussels, Belgium			✓	
Burgess Hill, United Kingdom		✓	✓	✓
Evora, Portugal			✓	
Madrid, Spain			✓	
RAF base, Oxfordshire, United Kingdom				✓
Stolberg, Germany		✓		✓
United States				
Dallas, Texas			✓	

Location	*SP/C*	*SP/M*	*TS/C*	*TS/M*
Denver, Colorado			✓	
Fort Worth, Texas			✓	
Tampa, Florida		✓		✓
Other				
Bangalore, India	✓			
Dubai, United Arab Emirates			✓	
Sao Paolo, Brazil			✓	
Santiago, Chile			✓	
Sydney, Australia		✓		✓
Zhuhai Guangdong, China			✓	

3.1 (a) Summary of Business Segments

Simulation Products/Civil (SP/C)

The Company builds civil simulators for all categories of aircraft including those built by Airbus, Boeing, Bombardier, Cessna, Dassault, Embraer, Gulfstream and Raytheon. CAE also builds simulators for civil helicopters, including models by AgustaWestland, Bell Helicopter, Boeing, Eurocopter and Sikorsky. During fiscal 2007, CAE was awarded 34 of 49 competed FFS orders or 69% of the third party competed market. Since its inception, CAE has taken orders for and delivered more than 700 FFS and FTDs from over 100 commercial airlines, aircraft manufacturers and third-party training centres in 45 countries. With over 50 years of experience in designing and manufacturing FFSs and other flight training devices, CAE has established long-standing relationships with leading commercial airlines throughout the world.

CAE expects to maintain a leadership position in civil simulation systems by anticipating future customer needs through both its own training experience and trusted relationships with equipment customers, commitment to innovation and technology, product quality, reliability and efficiency, and continuing efforts to lower costs and shorten delivery cycles. CAE expects to improve on its lead-time, cost, quality and reputation for performance through operational improvements and research and development programs.

CAE's capabilities in simulation-based interactive learning, including its leading-edge CAE Simfinity® system, also complement its traditional strength in FFS and FTDs. In fiscal 2007, CAE sold 19 3D CAE Simfinity® devices (Integrated Procedures Trainers (IPT) and Maintenance/Flight Training Devices (M/FTD, FTDs). Combined with a growing network of training centres, this complete suite of simulation-based equipment and training products permits CAE to offer airlines and business jet operators a complete range of training solutions.

CAE also offers a full range of support services, including technical support, spare parts sales, simulator updates and relocations.

The Simulation Products Group consolidates all manufacturing activities and includes engineering, program management, global procurement, and the marketing and sales of civil simulation products and military simulation equipment and training services. It is focused on substantially reducing the costs associated with manufacturing simulation equipment intended both for sale to third parties as well as for installation in the Company's own global network of training centres.

Training & Services/Civil (TS/C)

In 2001, CAE entered the civil flight training business by opening pilot training centres in Sao Paulo, Brazil and Toronto, Canada and acquiring Schreiner Aviation Training BV and SimuFlite Training International, Inc. Today, 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, 2007, CAE had an installed base of 110 civil FFS in 22 locations on four continents. Taking into account the interest of joint venture partners and other interests, CAE had in its network an average of 99 Revenue Simulator Equivalent Units (RSEUs) generating revenue for the Company during fiscal 2007.

CAE continues to expand its global network of strategically located training centres. CAE's customers at the commercial aviation training centres include major, low-cost 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 centres are used by more than 3,000 airline/corporate customers who tend to use third party training centres as their primary source for simulation training. CAE will continue to execute its pilot and maintenance crew training strategy, focusing on ramping up utilization and increasing yield (through enhanced service offerings) in the training centres owned or operated by CAE.

During fiscal 2005, CAE and Dassault Aviation signed a contract making CAE the exclusive provider of entitlement training for the new Falcon 7X aircraft. Entitlement training is the initial training provided by the aircraft manufacturer with the purchase of the aircraft. The agreement covers pilot, maintenance and cabin crew training. As part of this agreement, CAE qualified the world's first Falcon 7X FFS in the North East Training Center and has begun delivering a comprehensive training program that will incorporate CAE Simfinity® training technology.

The major priorities of TS/C are to increase revenue per simulator in the Company's global network of training centres, and to deliver the most cost-effective and competitive training service in the marketplace. To this end, TS/C has in fiscal 2007 completed the consolidation of training centres where duplication existed, and reallocated a number of simulators to maximize yield. While the restructuring is complete, TS/C will continue to look for ways to optimize its network of RSEUs, including the sale or purchase from time to time of used FFS. TS/C is continually developing new courseware and related training services to encourage customers to migrate from renting time on a CAE simulator (dry training) to accepting the training and curriculum provided by CAE instructors (wet training).

Simulation Products/Military (SP/M)

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 maritime patrol/transport planes. Its military simulators provide high fidelity combat environments that include interactive enemy and friendly forces, 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 Forward Looking Infra Red (FLIR) and radar sensors. CAE also provides turnkey military training services through the Company's MSHATF in the UK, its C-130 training facility in Tampa, Florida, and the Rotorsim Training Centre in Italy. Rotorsim is owned equally by CAE and AgustaWestland.

CAE has delivered simulation products and provided training services to the military forces of almost 50 countries. CAE has provided simulators for a wide range of aircraft and has designed training systems for the greatest variety of helicopters. CAE is also recognized as the world's leading provider of simulation and training solutions for the C-130 Hercules transport aircraft. The Company has established a leading position in Europe in the supply of army command and staff training systems, by supplying such systems to the forces of Germany, Austria, Italy, Norway, Finland, Lithuania, 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. In addition, the Medallion visual system is being used to upgrade the US Army's Apache combat mission simulators, the German Tornado simulators, and the US Army's 160th Special Operations Aviation Regiment's MH-47 and MH-60 combat mission simulators. CAE's Medallion image generator is also being installed on new-build simulators, including the MH-47G and MH-60L combat mission simulators for the US Army's 160th Special Operations Aviation Regiment, the AW139 simulator for AgustaWestland, the E-6B operational flight trainer for the US Navy, and EH101 full crew mission simulator for the Italian Navy.

CAE continues to 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. 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 defence contractors, will enable it to further penetrate the US military simulation and training market. CAE intends to continue to foster partnerships with key original equipment manufacturers and prime contractors. For example, EADS CASA selected CAE as its preferred training systems provider for the C-295 aircraft, and we are currently developing C-295 simulators for the EADS CASA training centre in Spain and the Brazilian Air Force. We are also working with EADS CASA to support other C-295 aircraft

programs around the world. Boeing selected CAE to provide the training systems for the US Air Force's C-130 Avionics Modernization Program, and in fiscal 2007, Boeing also recognized CAE with its Outstanding Supplier Award for outstanding responsiveness and support during development of new business opportunities. CAE continues to expand its relationship with Israel Aircraft Industries (IAI) to develop solutions for embedded training as well as for live and integrated virtual training. The Company also has continuing relationships

with AgustaWestland through Rotorsim, and with Lockheed Martin as the training system provider for the C-130J aircraft.

The military simulation equipment market is driven in part 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 improve its lead-time, cost, quality and reputation for performance through continued operational improvements and research and development programs. With leading-edge technology solutions, 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.

In fiscal year 2007, SP/M secured a range of new business with military forces around the world. In addition to those SP/M milestones identified in Section 2.1(b) "History" above, highlights of the past year include winning contracts to:

- Design a new P-3C operational tactics trainer (OTT) for the German Navy.The P-3C OTT will be used by the German Navy to train the rear-crew sensor operators in the P-3C Orion aircraft. When networked with the P-3C operational flight trainer (OFT), which CAE is also currently upgrading, the German Navy will have a fully-integrated P-3C full mission simulator capable of training the pilots and sensor operators for all the missions performed in this aircraft.
- Provide the British Army with 36 Warrior Infantry Fighting Vehicle (IFV) GunneryTurret Trainers. These trainers will be used to train British Army crewmen and commanders in the gunnery operations of the Warrior IFV. The initial delivery of four trainers was delivered to the Armoured Fighting Vehicle (AFV) Gunnery School inLulworth U.K. CAE is currently developing 32 additional trainers to be delivered throughout 2007 to British Army armoured infantry units deployed across the U.K. and Germany. In addition, the Warrior IFV Gunnery Turret Trainers will be network-enabled,allowing for a platoon trainer capability.
- Under contract from the Boeing Company to design and develop upgrades and newtraining devices for the US Air Force C-130 Avionics Modernization Program (AMP).
  Initially, CAE is upgrading an existing C-130H Weapon Systems Trainer, and willdeliver the upgraded simulator in a C-130 AMP configuration in early 2009. CAE is alsoupgrading an existing C-130 Cockpit Familiarization Trainer, Cockpit ProceduresTrainer, and Fuselage Trainer to the C-130 AMP configuration, and will design andmanufacture a new C-130 AMP Avionics Part Task Trainer. Under C-130 AMP, the USAir Force is expected to upgrade over 200 C-130H aircraft to the AMP configuration.The AMP upgrade will bring the C-130 aircraft into compliance with current navigationand safety requirements as well as improve reliability and reduce lifecycle costs.

Training & Services/Military (TS/M)

Military support services include the provision of contractor logistics support, maintenance services and simulator instruction at over 60 sites worldwide. CAE provides maintenance support for most of the Canadian Forces flight simulators and most of the flight simulators operated by 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 Predator UAV operators at Creech

Air Force Base (AFB) in Nevada. CAE also supports the training and mission rehearsal systems used by the US Army's elite 160th Special Operations Aviation Regiment as part of the Special Operations Forces Mission Rehearsal and Training Services (SOFMRTS) program. In 2006, CAE began providing live (airborne) training to Royal Australian Air Force (RAAF) aircrews flying C-130J and C-130H tactical transports. CAE personnel already provide simulator and classroom instruction as well as maintenance and support services at RAAF Base Richmond, home of the RAAF's Airlift Group. CAE also provides a range of support services to facilities in the UK, the Netherlands and Italy, as well as mission software support for Canada's CF-18 fighter aircraft.

In fiscal year 2007, a key strategic win for TS/M occurred when CAE won a competitive procurement to provide the US Marine Corps (USMC) with engineering support services for the training devices of two aircraft, the AV-8B and the KC-130. As prime contractor for the In-Service Engineering Office (ISEO), CAE will provide on-site technical support and engineering change modifications to USMC AV-8B and KC-130 trainers located at Marine Corps Air Station (MCAS) Cherry Point, North Carolina and MCAS Yuma, Arizona. Another milestone in fiscal year 2007 was the official opening of the Rotorsim Training Centre in Italy. The TS/M group experiences steady business revenue from its long-term training service contracts. These include contracts such as the Medium Support Helicopter Aircrew Training Facility (MSHATF) at Royal Air Force Base Benson in the UK and maintenance and service contracts to support almost all of the German Armed Forces flight simulators. The training service delivery at the MSHATF is indicative of the trend for militaries to use synthetic training for more distributed, mission preparation-type training. For example, the RAF regularly conducts "Thursday War" exercises that involve the networking of various simulators and computer generated forces in mission scenarios. Other ongoing services contracts that provide steady revenue streams for CAE include the instruction, maintenance and support services under subcontract to Lockheed Martin for C-130 and C-130J training systems for the US Air Force as well as the operation of the US Air Force Predator UAV schoolhouse at Creech AFB. In fiscal

year 2007, the TS/M group continued to win contracts for the provision of maintenance and support services for defence forces around the world, including a contract to support the Royal Navy Merlin helicopter training devices at RNAS Culdrose.

Military Contract Issues Generally

The majority of CAE's contract revenue in its SP/M and TS/M 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.

Discontinued Operations

Marine Controls

On February 3, 2005, we completed the sale of the substantial components of the Marine Controls segment to L-3 Communications Corporation (L-3), for a cash consideration of $238.6 million. This amount was subject to the approval by L-3 of the net working capital of the Marine Controls segment. The parties completed the discussions regarding the net working capital in the second quarter of fiscal 2007, and L-3 was paid for the difference in the net working capital. We received from L-3 in fiscal 2007 notices of claims for indemnification pursuant to the Sale and Purchase Agreement (SPA), including in respect of allegations that we were in breach of certain representations and warranties in the SPA. At this time, neither the outcome of these matters nor the potential future payments, if any, are determinable. We intend to assert all available defences against these claims. The aggregate liability for claims made under the SPA is limited to US$25 million.

Forestry Systems

On August 16, 2002, CAE sold substantially all the assets of the sawmill division of its Forestry Systems to Coe Newnes/McGehee ULC (now named Coe Newnes/McGehee Inc.) and Coe Newnes/McGehee Corp., entities under the control of Three Cities Research Inc. The Company was entitled to receive further cash consideration from the sale based on operating performance of the disposed business for the three-year period from August 2002 to August 2005. In November 2005, the Coe buyers notified the Company that the level of operating performance required to trigger a further payment had not, in their view, been achieved. CAE completed a review of the buyers' books and records and in January 2006 instituted legal proceedings to collect the payment that it believes is owed to the Company. The parties have agreed to refer certain elements of the dispute to arbitration, which is underway.

Cleaning Technologies and Other

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. During the first quarter of fiscal 2007, an agreement was reached to settle the further consideration for an amount of $0.25 million.

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 (R&D). Each business segment is encouraged to apply R&D across the whole spectrum of its operations, from product development to production processes and techniques.

An additional part of CAE's R&D 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, R&D 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.

In November 2005, CAE announced the launch of Project Phoenix, a $630-million, six-year R&D initiative, the goal of which is to improve current leading-edge technologies and to develop additional ones that will build on CAE's position as a world leader in simulation, modelling, training and services. The Government of Canada agreed in fiscal 2006, through Technology Partnerships Canada (TPC), to invest up to 30% ($189 million) of the value of CAE's R&D program. The Government of Québec agreed in fiscal 2007, through Investissement Québec, to invest up to a further $31.5 million in Project Phoenix. In the past few years, the Company has also been involved with various other TPC projects on R&D programs involving visual systems and advanced flight simulation technology for civil applications and networked simulation for military applications. These investments by TPC and Investissement Québec are repayable through revenue-based royalties starting in fiscal year 2012.

Total R&D expenditures include basic R&D costs as well as program related development costs. Basic internal R&D expenditures were, for fiscal 2007, largely associated with the development of the 5000 and 7000 Series full flight simulators, the CAE STRIVE™ framework and applications to support the CAE NeTTS™ architecture, the new generation CAE Simfinity® platform and courseware development and the Medallion™-6000 and Tropos® 6000 visual systems, including LCoS projection display technology and a new generation of database content generation and deployment tools (Database-on-Demand and Motif Compositing™) based on the Common Environment / Common Database (CE/CDB) technology developed for the US Special Forces. In addition, CAE has invested in a number of new product initiatives that leverage core CAE technologies including STRIVE®, CE/CDB and visualization. These include the Advanced Visionics System (AVS), a helicopter navigation system that fuses synthetic environment and sensor data providing visibility in poor/no visibility situations (brown-outs), Airborne Embedded Training System (AETS) that takes synthetic training to the live domain, and a UAV C4I (command, control, communication, computers and intelligence) system that takes the STRIVE® simulation framework to an operational environment. Basic research and development expenditure in fiscal 2008 will be primarily focused on new aircraft simulator product development for the 5000 and 7000 Series platforms, existing product enhancements. early work on a new high-end, 5000 Series – derived platform for various aircraft, as well as the development and deployment of AVS and AETS demonstrator systems and a proof-of-concept UAV C4I system.

3.1 (b) Production and Services

Production

CAE's manufacturing and assembly 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 six major stages: design, manufacture and assembly, testing, shipping, site installation and final test on site. Military simulators are more complex and unique than civil simulators, and therefore may take more time to design, manufacture and test.

Manufacturing is organized into 10 manufacturing cells comprised of the following three major disciplines: electronics (printed circuit board assembly), electrical (cables, cabinets, aircraft instruments and avionics), and mechanical (sheet metal and machine shop, precision assembly and hydraulics, structural assembly and final assembly). Each cell has its own planning, methodizing and set of specific products to deliver, which establishes clear accountability for manufacturing performance.

The majority of our manufacturing activities for civil and military simulation systems is conducted at CAE's facilities in Montreal, with integration and update related work also being conducted at the Tampa, Burgess Hill and Stolberg sites. The Tampa facility conducts the majority of military systems integration and testing activities for simulation equipment destined for US military-related contracts.

Services

CAE's flight training services are provided to customers as described in section 5.1(a), "Summary of Business Segment", of this AIF.

CAE 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 FFS while providing valuable insights into customer training needs.

3.1 (c) Specialized Skill and Knowledge

CAE employs predominantly graduates in engineering and software development, as well as pilots, instructors and other flight training experts. As an industry leader, CAE is able to train its staff in the technology and software required for simulation software and equipment. Flight trainers are typically recruited from the ranks of former airline or military pilots. CAE has not experienced material difficulty in recruiting appropriate staff to carry out its manufacturing, training and development work.

3.1 (d) Competition

The markets in which CAE sells its products are highly competitive. Certain competitors are also the Company's customers, partners 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 quality, performance, and flexibility of its products and services;
- reputation for prompt and responsive contract performance;
- accumulated technical knowledge, intellectual property and expertise;
- strong after sales support;
- flexibility of product/service offerings being susceptible to tailor-made customersolutions;
- breadth of product line; and
- price.

CAE's future success will depend in large part upon its ability to improve existing product lines, develop new products and technologies in the same or related fields, improve delivery intervals and reduce the costs it incurs in producing its products and services.

CAE's major competitors in the military simulation and training market include Lockheed Martin, L-3 Communications Link Simulation and Training, Boeing, Rockwell Collins, Indra Systems, BAE Systems, Thales, Flight Safety International, SAIC, 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, Rockwell Collins, Flight Safety International, and smaller players such as Mechtronix Systems and Sim Industries. Some of these competitors are low cost providers with a limited product portfolio which only addresses a subset of the overall market while others offer a broader product portfolio. The Company's major competitors in civil pilot training include Flight Safety International, Alteon Training, newly-formed GCAT and PanAm International Flight Academy.

3.1 (e) Components

CAE deals with a variety of goods and services suppliers across its business segments. Although it is not overly dependent on any single supplier for any key manufacturing components or services, 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.

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.

3.1 (f) Intangible Properties

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 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 and Investissement Québec restrict, in some cases, 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 consent has been obtained.

Given CAE's many decades of success in the field of aviation simulation, the Company believes that the CAE brand and some of its trademarked products have value in the markets it addresses.

3.1 (g) Cycles

The SP/M and TS/M segments sell to government customers such that there is no evident cycle to the intake of orders, but such order levels may vary significantly from quarter to quarter because of the irregular timing of government orders. The SP/C segment's equipment sales to airlines are affected by the cycles of expansion and contraction of the entire commercial airline industry. The TS/C segment's flight training services do experience an element of seasonality; in times of peak travel (holiday periods, etc.) airline and business jet pilots are often too busy flying aircraft to attend training sessions. TS/C may also be somewhat affected by the longer wave cycles of the commercial airline industry, though not to the same degree as SP/C.

3.1 (h) Environmental Protection

CAE believes its current operations are in compliance in all material respects with environmental laws and regulations. Environmental protection requirements do not have material financial or operational effects on the Company's capital expenditures, earnings or competitive position.

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 health and safety and environmental laws and regulations in the various countries in which CAE operates or has operated. Examples of claims in respect of former CAE operations include two claims against CAE in respect of the former CAE Electronics facility at the Edmonton International Airport, both of which CAE is contesting.

Separately, the New York State Department of Environmental Conservation (DEC) considers that Trichloroethylene (TCE) is present in ground water at or near CAE-USA's former Link Hillcrest New York facility site and is evaporating and following soil vapors into homes. The DEC has initiated the installation of an air pump system in affected homes to remedy the effect of such evaporation. The DEC continues to try to determine which properties, and parties, may have contributed to the alleged contamination. CAE is in discussions with the DEC, a

neighboring company and local officials to examine ways of resolving these concerns; no order has been issued against CAE in this regard.

3.1 (i) Employees

CAE currently employs about 5,500 full-time employees of which approximately 800are unionized and covered by 11 collective agreements. Five labor contracts were ratified in fiscal 2007. During fiscal 2008, CAE will enter into negotiations for the renewal of two collective agreements. The collective agreement for 600 employees in Montreal will remain in 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.

3.1 (j) Foreign Operations

For the fiscal year ended March 31, 2007, sales to customers outside Canada accounted for approximately 89% of CAE's revenue such that CAE is very dependent upon foreign sales and operations. The Company expects that sales outside Canada will continue to account for most of its revenue for the foreseeable future.

CAE's 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 defence contractors who are important decision makers regarding defence contracts.

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 spend aportion 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 foreignarms 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 variouscountries;
- 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.

3.2 Risk Factors

We operate in several industry segments that have various risks and uncertainties. Management and the board discuss the principal risks facing our business, particularly during the annual strategic planning and budgeting processes. These are described below.

Management attempts to mitigate risks that may affect our future performance through a process of identifying, assessing, reporting and managing risks that are significant from a corporate perspective.

Length of sales cycle

The sales cycle for our products and services is long and unpredictable, ranging from six to 18 months for civil aviation applications and from six to 24 months or longer for military applications. During the time when customers are evaluating our products and services, we may incur expenses and management time. Making these expenditures in a quarter that has no corresponding revenue will affect our operating results and could increase the volatility of our share price.

Product evolution

The civil aviation and military markets we operate in are characterized by changes in customer requirements, new aircraft models (such as the Boeing 787 and Airbus A350) and evolving industry standards such as our recently launched CAE 5000 Series FFS. If we do not accurately predict the needs of our existing and prospective customers or develop product enhancements that address evolving standards and technologies, we may lose current customers and be unable to bring on new customers. This could reduce our revenue. The evolution of the technology could also have an impact on the value of our fleet of FFSs.

Level of defence spending

A significant portion of our revenue comes from sales to military customers around the world. In fiscal 2007, for example, sales by the SP/M and TS/M segments accounted for 45% of our revenue. We are either the primary contractor or a subcontractor for various programs by Canadian, US, European, and other foreign governments. If funding for a government program is cut, we could lose future revenue, which could have a negative effect on our operations. If countries we have contracts with significantly lower their military spending, there could be a material negative effect on our sales and earnings.

Civil aviation industry

A significant portion of our revenue comes from supplying equipment and training services to the commercial and business airline industry.

While major airlines continue to face financial difficulties, we have seen a surge of new aircraft orders in 2007, which is encouraging. Most of these aircraft are destined for carriers in the Middle East and Asia.

Fluctuating prices for airplane fuel also have a material effect on the profitability of many airlines. If fuel prices remain high for a sustained period, deliveries of new aircraft could be delayed or cancelled, which would negatively affect the demand for our training equipment and services.

We are also exposed to credit risk on accounts receivable from our customers, but have adopted policies to ensure we are not significantly exposed to any individual customer. Our policies include analyzing the financial position of our customers and regularly reviewing their credit quality. We also subscribe from time to time to credit insurance and in some instances require a bank letter of credit.

Competition

We sell our simulation equipment and training services in highly competitive markets, and new entrants are emerging and positioning themselves to take advantage of a positive market outlook. Some of our competitors are larger than we are, 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 when competing for projects for these organizations.

We obtain most of our contracts through competitive bidding processes that subject us to the risk of spending a substantial amount of time and effort on proposals for contracts that may not be awarded to us. We cannot be certain that we will continue to win contracts through competitive bidding processes at the same rate as we have in the past.

Foreign exchange

Approximately 90% of our revenue is generated in foreign currencies and this will continue to be the case. Conversely, a proportion of our operating expenses are in Canadian dollars. Any significant change in the value of the Canadian dollar will cause volatility in our results of operations, cash flow and financial condition from period to period. We have developed various cash flow hedging programs to partly offset this exposure on the business already booked in the backlog. The Canadian dollar has also made Canada a more expensive manufacturing environment for us. If the Canadian dollar increases in value it will negatively affect our financial results and our competitive position compared to other equipment manufacturers in jurisdictions where operating costs are lower.

Doing business in foreign countries

We have operations in many countries and sell our products and services to customers around the world. Sales to customers outside Canada and the US made up approximately 60% of revenue in fiscal 2007. We expect sales outside Canada and the US to continue to represent a significant portion of revenue for the foreseeable future. As a result, we are subject to the risks of doing business internationally.

These include foreign exchange risk, as discussed above, and the risk that laws and regulations in host countries will change, which can have an effect on:

- The cost and complexity of using foreign representatives and consultants.
- Tariffs, embargoes, controls and other restrictions that may affect the free flow of goods,information and capital.
- The complexities of managing and operating an enterprise and complying with laws inmultiple jurisdictions.
- General changes in economic and geopolitical conditions.

Our currency hedging activities are used to protect profit margin on booked business. Variations in exchange rate might have an impact on the profit margin for future contracts on which we are competing to win.

Fixed-price and long-term supply contracts

We provide our products and services mainly through fixed-price contracts that require us to absorb cost overruns, even though it can be difficult to estimate all of the costs associated with

these contracts or to accurately project the level of sales we may ultimately achieve. In addition, a number of contracts to supply equipment and services to commercial airlines are long-term agreements that run up to 20 years. While these contracts can be adjusted for increases in inflation and costs, the adjustments may not fully offset the increases, which could negatively affect the results of our operations.

Integration risk

Our business could be negatively affected if our products do not successfully integrate or operate with other sophisticated software, hardware, computing and communications systems that are also continually evolving. If we experience difficulties on a project or do not meet project milestones, we may have to devote more engineering and other resources than originally anticipated. While we believe we have recorded adequate provisions for losses on fixed-price contracts, it is possible that fixed-price and long-term supply contracts could subject us to additional losses that exceed obligations under the terms of the contracts.

Government-funded military programs

Like most companies that supply products and services to governments, we can be audited and reviewed from time to time. Any adjustments that result from government audits and reviews may have a negative effect on our results of operations. Some costs may not be reimbursed or allowed in negotiations of fixed-price contracts. We may also be subject to a higher risk of legal actions and liabilities than companies that cater only to the private sector, which could have a materially negative effect on our operations.

If we fail to comply with government regulations and requirements, we could be suspended or barred from government contracts or subcontracts for a period of time, which would negatively affect our revenue from operations and profitability and could have a negative effect on our reputation and ability to procure other government contracts in the future.

Research and development activities

We have carried out some of our research and development initiatives with the financial support of government agencies, including the Government of Canada through Technology Partnerships Canada and the Government of Québec through Investissement Québec. If we do not receive this financial support in the future, there is a risk that we may not be able to replace this with other assistance.

Protection of intellectual property

We rely in part on trade secrets and contractual restrictions, such as confidentiality agreements and licences, to establish and protect our proprietary rights. These may not be effective in preventing a misuse of our technology or in deterring others from developing similar technologies. We may be limited in our ability to acquire or enforce our intellectual property rights in some countries.

Intellectual property

Our products contain sophisticated software and computer systems that are supplied to us by third parties. These may not always be available to us. Our production of simulators often depends on receiving confidential or proprietary data on the functions, design and performance

of a product or system that our simulators are intended to simulate. We may not be able to obtain this data on reasonable terms, or at all.

Infringement claims could be brought against us or against our customers. We may not be successful in defending these claims and we may not be able to develop processes that do not infringe on the rights of third parties, or obtain licences on terms that are commercially acceptable, if at all.

Litigation related to our intellectual property rights could be lengthy and costly and could negatively affect our operations or financial results, whether or not we are successful in defending a claim.

Environmental liabilities

We use, generate, store, handle and dispose of hazardous materials at our operations, and our past operations. Past operators at some of our sites also carried out these activities.

New laws and regulations, stricter enforcement of existing laws and regulations, the discovery of previously unknown contamination, new clean-up requirements or claims on indemnities we have given may mean we have to incur substantial costs. This could have a materially negative effect on our financial condition and results of operations.

We have made provisions for claims we know about and remediation we expect will be required, but there is a risk that our provisions are not sufficient.

In addition, our discontinued operations are largely uninsured against such claims, so an unexpectedly large environmental claim against a discontinued operation could reduce our profitability in the future.

Liability claims arising from casualty losses

Because of the nature of our business, we may be subject to liability claims, including claims for serious personal injury or death, arising from accidents or disasters involving training equipment we have sold or aircraft for which we have provided training equipment or services. We may also be subject to product liability claims relating to equipment and services our discontinued operations sold in the past. We cannot be certain that our insurance coverage will be sufficient to cover one or more substantial claims.

Warranty or other product-related claims

We manufacture simulators that are highly complex and sophisticated. These may contain defects that are difficult to detect and correct. If our products fail to operate correctly or have errors, there could be warranty claims or we could lose customers. Correcting these defects could require significant capital investment. If a defective product is integrated into our customer’s equipment, we could face product liability claims based on damages to the customer’s equipment. Any claims, errors or failures

could have a negative effect on our operating results and business. We cannot be certain that our insurance coverage will be sufficient to cover one or more substantial claims.

Regulatory rules imposed by aviation authorities

We are required to comply with regulations imposed by aviation authorities. These regulations may change without notice, which could disrupt our sales and operations. Any changes imposed by a regulatory agency, including changes to safety standards imposed by aviation authorities such as the US Federal Aviation Administration, could mean we have to make unplanned modifications to our products and services, cause delays and result in cancelled sales. We cannot predict the impact of changing laws or regulations might have on our operations. Any changes could have a materially negative effect on our results of operations or financial condition.

Sales or licences of certain CAE products require regulatory approvals

The sale or licence of virtually all of our products is subject to regulatory controls. These can prevent us from selling to certain countries, and require us to get an export licence or other approvals to sell certain technology such as military-related simulators or other training equipment, including military data or parts. These regulations change often and we cannot be certain that we will be permitted to sell or license certain products to customers, which can cause a potential loss of revenue for us. Failing to comply with any of these regulations in countries where we operate could result in fines and other material sanctions.

Key personnel

Our continued success will depend in part on our ability to retain and attract key personnel with the relevant skill, expertise and experience. Our compensation policy is designed to mitigate this risk.

Enterprise resource planning

We are investing time and money in a new ERP system. If the system does not operate as expected or when expected, it may be difficult for us to claim compensation or correction from the supplier. We may not be able to realize the expected value of the system and this may have a negative effect on our operations, profitability and reputation.

Integration of businesses acquired

The success of our acquisitions depend on our ability to crystallize synergies both in terms of broadening our product offering as well as consolidating the operations of the business acquired as part of our existing operations.

4. DIVIDENDS

CAE currently intends to maintain its quarterly dividend of $0.01 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. The Company's contracts with Technology Partnerships Canada prohibit the payment of a dividend if such payment would prevent payment to Technology Partnerships Canada of a royalty owed under the contracts.

The Company's Dividend Reinvestment Plan (DRIP) provides that Canadian resident eligible shareholders can elect to receive common stock dividends in lieu of cash dividends. During fiscal 2005, 2006 and 2007, CAE issued 126,901, 42,997 and 21,124 common shares, respectively, as share dividends.

5. 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.

As at the close of business on March 31, 2007, 251,960,449common shares were issued and outstanding. There are no preferred shares issued and outstanding.

6. 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".

6.1 Trading Price and Volume

CAE Inc.
TSX Share Price Information - FY 2007

Month	Max	Min	Total Volume
April-06	$ 9.65	$ 9.13	17,503,064
May-06	$ 9.76	$ 9.00	16,452,793
June-06	$ 9.23	$ 8.09	20,725,448
July-06	$ 8.99	$ 8.28	16,728,704
August-06	$ 9.68	$ 8.52	15,090,374
September-06	$ 9.67	$ 9.13	8,364,265
October-06	$ 10.45	$ 9.40	23,549,952
November-06	$ 10.64	$ 9.77	19,391,501
December-06	$ 10.90	$ 10.08	15,348,459
January-07	$ 12.08	$ 10.55	22,897,558
February-07	$ 12.69	$ 11.35	19,099,893
March-07	$ 13.35	$ 11.43	19,690,735

CAE Inc.
NYSE Share Price Information - FY 2007

Month	Max	Min	Total Volume
April-06	$ 8.42	$ 7.77	531,400
May-06	$ 8.88	$ 7.90	966,700
June-06	$ 8.35	$ 7.27	1,154,600
July-06	$ 7.91	$ 7.30	683,200
August-06	$ 8.74	$ 7.51	1,452,000
September-06	$ 8.68	$ 8.15	728,000
October-06	$ 9.19	$ 8.32	797,300

November-06	$	9.35	$ 8.64	925,500
December-06	$	9.52	$ 8.76	898,800
January-07	$	10.26	$ 8.97	951,200
February-07	$	10.85	$ 9.62	1,236,468
March-07	$	11.53	$ 9.74	1,003,300

7. 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 as of the date hereof, the positions and offices held by them in the Company, their respective principal occupations for the last five years, and the year in which they became a Director are set forth below. More information concerning CAE's Directors may be found in the Proxy Information Circular dated May 31, 2007, in connection with the Company's Annual and Special Meeting of Shareholders on June 28, 2007. 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 Human Resources Committee and the Executive Committee.

7.1 Name and Occupation

DIRECTORS

Name and Municipality of Residence and Year First Became a Director	**Principal Occupation**
BRIAN E. BARENTS Andover, Kansas, USA (2005)	Mr. Barents is a Director of several companies as well as a board member of the Flight Safety Foundation. A former Air National Guard Brigadier General and still an active pilot, Mr. Barents was the President, CEO and co-founder of Galaxy Aerospace Company, LP from 1997-2001 and before that President and CEO of Learjet, Inc. from 1989-1996. Mr. Barents is a member of the Human Resources Committee.
ROBERT E. BROWN Westmount, Quebec, Canada (2004)	Mr. Brown is President and Chief Executive Officer of CAE. Prior to joining CAE, Mr. Brown was Chairman of the Board of Air Canada from May 2003 to October 2004, and before this, Mr. Brown was President and Chief Executive Officer of Bombardier Inc. from February 1999 to December 2002. Mr. Brown was also Chairman of Lyrtech, Inc. and Allen-Vanguard Corporation and has served as a Director of other public companies. Mr. Brown is a member of the Executive Committee.
JOHN A. (IAN) CRAIG Ottawa, Ontario, Canada (2000)	Mr. Craig is a business consultant and a Director of Bell Canada International Inc., Arris International and the Ottawa Heart Institute. Mr. Craig is a member of the Audit Committee.
H. GARFIELD EMERSON, Q.C. Toronto, Ontario, Canada (1992)	Mr. Emerson is Principal, Emerson Advisory, and a Corporate Director. He was previously National Chair of Fasken Martineau DuMoulin LLP and the President and CEO of NM Rothschild & Sons Canada Limited, investment bankers. He is also a Director of various companies Mr. Emerson is a member of the Governance Committee.

Name and Municipality of Residence and Year First Became a Director	**Principal Occupation**
ANTHONY S. FELL, O.C. Toronto, Ontario, Canada (2000)	Mr. Fell is Chairman of RBC Capital Markets Inc. and was formerly Chairman and Chief Executive Officer of RBC Dominion Securities (and continues as a Director thereof) and Deputy Chairman of Royal Bank of Canada. Mr. Fell is also Chairman of Munich Reinsurance Company of Canada. Mr. Fell is the Chairman of the Governance Committee and a member of the Executive Committee.

PAUL GAGNÉ, CA Montreal, Quebec, Canada (2005)	Mr. Gagné is a Director of various publicly listed and private companies. Mr. Gagné is the Chairman of Wajax Income Fund and is a Director, and also chairs the Audit Committees, of Textron Inc., Inmet Mining Corporation and Fraser Papers Inc. Mr. Gagné is a member of the Audit Committee.
THE HONOURABLE JAMES A. GRANT, P.C., C.M., Q.C. Montreal, Quebec, Canada (1991)	Mr. Grant is a Partner in the legal firm of Stikeman Elliott LLP (Montreal) and a Director of various charitable and social organizations. Mr. Grant is a member of the Human Resources and Executive Committees.
JAMES F. HANKINSON, CA Toronto, Ontario, Canada (1995)	Mr. Hankinson is President and Chief Executive Officer of Ontario Power Generation Inc. He is also a Director of Maple Leaf Foods Inc. and Ontario Power Generation Inc. Mr. Hankinson is Chairman of the Audit Committee and a member of the Governance Committee.
E. RANDOLPH (RANDY) JAYNE II Tysons Corner, Virginia (2001)	Mr. Jayne is Senior Partner in Heidrick & Struggles International, Inc., an executive search firm and is currently the Office Managing Partner of the firm's Tysons Corner, VA and Washington DC offices. Mr. Jayne is a member of the Human Resources Committee.

Name and Municipality of Residence and Year First Became a Director	**Principal Occupation**
ROBERT LACROIX, Ph.D., CM, OQ, FRSC Montreal, Quebec, Canada (2005)	Dr. Lacroix holds a Ph.D in Economics, has been a Professor in the Department of Economics at the Université de Montréal since 1970, and Professor *emeritus* since 2006. He was Rector (President) of the Université de Montréal from 1998-2005. Dr. Lacroix is also member of the Board of the Trudeau Foundation, member of the National Statistics Council of Canada, and member of the Board of the Canada-USA Fullbright Foundation. His current position is Professor *emeritus,* Université de Montréal and he is also a Director of Pomerleau Inc., Industrial Alliance Inc., and Jean Coutu Group.
JAMES W. MCCUTCHEON, Q.C. Toronto, Ontario, Canada (1979)	Mr. McCutcheon is Legal Counsel and a Corporate Director. He is a Director of Canadian Satellite Radio Holdings Inc., Dominion of Canada General Insurance Company, Empire Life Insurance Company, and Guardian Capital Group Limited. Mr. McCutcheon is a member of the Audit Committee.
LAWRENCE N. STEVENSON Toronto, Ontario, Canada (1998)	Mr. Stevenson is Managing Director of Callisto Capital, a Toronto-based Private Equity firm which he joined in 2006, and a Director of SNC-Lavalin Group Inc. He was previously the CEO of Pep Boys, an Automotive Retail & Service Company based in Philadelphia. Mr. Stevenson is Chairman of the Human Resources Committee.
LYNTON R. WILSON, O.C. Oakville, Ontario, Canada (1997)	Mr. Wilson is Chairman of the Board of CAE, Chairman of the DaimlerChrysler Canadian Advisory Council and also of Allergen NCE Inc., and is a Director of DaimlerChrysler AG. He is

	Chairman of the Executive Committee and is a member of the Human Resources and Governance Committees.

OFFICERS

Name and Municipality of Residence	Office held with CAE and Principal Occupation[1]
MARC PARENT Blainville, Quebec, Canada	Group President, CAE Simulation Products and Military Training & Services; formerly Vice President and General Manager, Challenger Programs and Dorval Plants at Bombardier Aerospace (2004-2005); Vice President and General Manager at Bombardier Aerospace US operations (2003-2004); Vice President and General Manager, at Bombardier Aerospace, Toronto Site (former deHavilland) (2002- 2003).
JEFFREY G. ROBERTS Hudson, Quebec, Canada	Group President, Civil Training and Services and Innovation of CAE Inc. since 2002.
ALAIN RAQUEPAS, CA St. Lambert, Quebec, Canada	Vice President, Finance and Chief Financial Officer; formerly Vice President Finance, Military Simulation and Training (2001-2005).
HARTLAND J.A. PATERSON Westmount, Quebec, Canada	Vice President, Legal, General Counsel and Corporate Secretary, since 2001.
ANTOINE AUCLAIR, C.A. St. Lambert, Quebec, Canada	Vice President and Corporate Controller (2006 to present); formerly Vice President Finance and Controller at Bell Nordiq (2005-2006), Director Parts Logistics at Bombardier Aerospace (2004-2005) and Director Industrial Accounting at Bombardier Aerospace, Montreal Site (former Canadair) (2002-2004).

(1) Where the date 2002 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 2,756,597 common shares which represent 1.1% of the Company's outstanding common shares.

7.2 Cease, Trade Orders, Bankruptcies, Penalties or Sanctions

None of the Directors of CAE is, or within ten years prior hereto has been, subject to a cease trade or similar order except as set out below.

From May 31, 2004 until on or about June 21, 2005, certain Directors, senior officers and certain current and former employees of Nortel Networks Corporation ("Nortel") and Nortel Networks Limited ("NNL"), including Messrs. Brown and Wilson, were prohibited from trading in securities of Nortel and NNL pursuant to management cease trade orders issued by the Ontario Securities Commission ("OSC"), the Autorité des marchés financiers ("AMF") and certain other provincial securities regulators (collectively the “Regulators”) in connection with the delay in the filing of certain of their financial statements. The Regulators issued a further management cease trade order on April 10, 2006 in connection with the delay in filing certain 2005 financial statements prohibiting certain Directors, senior officers and certain current and former employees, including Mr. Brown, from trading in securities of Nortel and NNL. Following the filing of the required financial statements, the OSC and AMF lifted such cease trade orders effective June 8, 2006 and June 9, 2006, respectively, following which the other Regulators lifted their cease trade orders.

From August 28 to November 20, 1998, Mr. Emerson, as a Director of Livent Inc., was prohibited from trading in the securities of Livent pursuant to a management cease trade order issued by the OSC in connection with the delay in the filing of certain of its financial statements. Mr. Emerson resigned as a Director of Livent in November 1998; within a year of his resignation, Livent filed for bankruptcy.

Mr. Brown joined the board of Air Canada two weeks before it filed for protection under the Companies' Creditors Arrangement Act on April 1, 2003 to help manage the financial crisis in which that company found itself.

7.3 Conflicts of Interest

The law firm Stikeman Elliott LLP, of which Mr. Grant is a partner, provided legal services to the Company in fiscal 2006 and continues to provide such services to the Company. The law firm's fees to the Company are less than 1% of the law firm's annual consolidated gross revenues. Mr. Grant does not provide any such services personally.

Royal Bank of Canada, the parent entity of RBC Dominion Securities Inc. (of which Mr. Fell is Chairman), provided routine non-advisory lending and foreign exchange–related services to the Company in fiscal 2006 and continues to provide such services to the Company. The Bank's fees to the Company are less than 1% of the Bank's annual consolidated gross revenues.

8. TRANSFER AGENTS AND REGISTRARS

The Company only has common shares issued. The Company's transfer agent is Computershare Trust Company of Canada located at 100 University Avenue, 9th Floor, Toronto, Ontario, M5J 2Y1.

9. AUDIT COMMITTEE

9.1 Mandate

The mandate of CAE's Audit Committee is as set out in Schedule B hereto.

9.2 Membership

The members of CAE's Board of Directors' Audit Committee are:

Mr. James F. Hankinson (chair)
Mr. James W. McCutcheon, Q.C.
Mr. John A. (Ian) Craig
Mr. Paul Gagné

Each of these members is independent and financially literate.

Mr. Hankinson is a chartered accountant and has an MBA from McMaster University. In addition to his current activities set out in the Directors table above, he served as President and Chief Executive Officer of New Brunswick Power Corporation from 1996 to 2002. In 1973, he joined Canadian Pacific Limited, and served as Chief Operating Officer from 1990 to 1995. Mr. Hankinson is also a member of the Audit Committee of the Board of Directors of Maple Leaf Foods Inc.

Mr. McCutcheon has extensive board experience. He is Legal Counsel and a Director of various companies and charitable organizations. He has served as Chairman of the Audit Committees of the Boards of Directors of Noranda Inc., The Empire Life Insurance Company, Guardian Capital Group, and others.

Mr. Craig has extensive board experience. He is also member of the Audit Committees of the Boards of Directors of Bell Canada International Inc. and ARRIS Group Inc.

Mr. Gagné is a chartered accountant. In addition to his current activities set out in the Directors table above, he also chairs the Audit Committees of the Boards of Directors of Textron Inc., Inmet Mining Corporation and Fraser Papers Inc. The CAE Board has determined that such simultaneous service does not impair the ability of Mr. Gagné to effectively serve on CAE's Audit Committee.

9.3 Approval of Services

The Audit Committee is responsible for the appointment, compensation, retention and oversight of the work of its independent auditor. The Audit Committee must pre-approve any audit and non-audit services performed by PricewaterhouseCoopers LLP (PwC), the auditor of the Company, or such services must be entered into pursuant to the policies and procedures established by the Committee. Pursuant to such policies the Audit Committee annually authorizes CAE and its affiliates to engage the auditor for specified permitted tax, financial advisory and other audit-related services up to specified fee levels. The Audit Committee has considered and concluded that the provision of these services by PwC is compatible with

maintaining PwC's independence. The Audit Committee's policy also identifies prohibited services that PwC is not to provide the Company.

The following chart shows all fees paid to PwC by the Company and its subsidiaries in the most recent and prior fiscal years for the various categories of services (generic description only).

FEE TYPE	2007	2006
	($ MILLIONS)	
1. Audit services	3.6	2.3
2. Audit-related services	0.4	0.3
3. Tax services	0.8	0.6
Total	4.8	3.2

1. Audit fees are comprised of fees billed for professional services for the audit of CAE's annual financial statements and services that are normally provided by PwC in connection with statutory and regulatory filings, including the audit of the internal controls over financial reporting as required by the Sarbanes-Oxley legislation.

2. Audit-related fees are comprised of fees relating to work performed in connection with CAE's divestitures.

3. Tax fees are related to tax compliance support.

10. 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 May 31, 2007, in connection with the Company's Annual and Special Meeting of Shareholders on June 28, 2007. 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, 2007. A copy of such documents may be obtained from the Vice President, Global Communications 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 Vice President, Global Communications 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 as at March 31, 2007. All companies are wholly owned except as noted.

Name of Subsidiary	Jurisdiction of Incorporation
Canada	

4341392 Canada Inc	Canada
CAE International Holdings Limited	Canada
CAE Machinery Ltd.	British Columbia
CAE Professional Services (Canada) Inc.	Canada
CAE Railway Ltd.	Canada
CAE Services (Canada) Inc.	Canada
CAE Simulator Services Inc.	Quebec
United States	
CAE (US) Inc.	Delaware
CAE (US) LLC	Delaware
CAE USA Inc	Delaware
CAE North East Training Inc.	Delaware
CAE SimuFlite Inc	Texas
Civil Aviation Training Solutions Inc	Florida
Terrain Experts, Inc.	California
Europe	
Academia Aeronautica De Evora S.A.(56%)	Portugal
B.V. Nationale Luchtvaartschool	Netherlands
CAE Aircrew Training Services plc (78%)	United Kingdom
CAE Aviation Training B.V	Netherlands
CAE Beyss Grundstücksgesellschaft GmbH	Germany
CAE Center Amsterdam B.V	Netherlands
CAE Center Brussels N.V	Belgium
CAE Center Maastricht B.V	Netherlands
CAE Elektronik GmbH	Germany
CAE Euroco S.à.r.l.	Portugal
CAE Holdings BV	Netherlands
CAE Holdings Limited	United Kingdom
CAE International Capital Management Hungary LLC	Hungary
CAE Investments S.à r.l	Luxembourg
CAE Services Italia, S.r.l.	Italy
CAE STS Limited	United Kingdom
CAE Training Aircraft B.V	Netherlands
CAE (UK) plc	United Kingdom

Name of Subsidiary	Jurisdiction of Incorporation
CAE Verwaltungsgesellschaft mbH	Germany
CityLine Canadair Simulator und Training GmbH (15%)	Germany
CVS Leasing Limited (13.39%)	United Kingdom
Helicopter Training Media International GmbH	Germany
HFTS Helicopter Flight Training Services GmbH	Germany
Invertron Simulators plc	United Kingdom
Landmark Operations Limited	United Kingdom
Landmark Training Limited	United Kingdom
Rotorsim (Consortium) (50%) [1]	Italy
SAGO Grünstucks-Verwaltungsgesellschaft mbH (51%)	Germany
SAGO Grünstucks-Verwaltungsgesellschaft mbH & Co. KG (95%)	Germany
Servicios de Instrucción de Vuelo, S.L. (80%)	Spain
Simubel N.V. (a CAE Aviation Training Company)	Belgium
SIV Ops Training, S.L.	Spain
ZFB Zentrum für Flugsimulation Berlin GmbH (17%)	Germany
Other	
CAE Australia Pty Ltd	Australia
CAE Aviation Training Chile Limitada [2]	Chile
CAE Aviation Training International Ltd	Mauritius
CAE Dubai LLC (49%)	Dubai
CAE Labuan Inc.	Malaysia
CAE Simulation Technologies Private Limited	India
CAE South America Flight Training do Brasil Ltda	Brazil
Flight Training Device (Mauritius) Limited	Mauritius

KESEM International Pty Ltd.	Australia
Zhuhai Xiang Yi Aviation Technology Company Limited (49%)	China

DISCONTINUED OR INACTIVE

Name of Subsidiary	Jurisdiction of Incorporation
CAE Beteiligungsgesellschaft mbH	Germany
CAE CT Inc	California
CAE MRAD Pty Ltd	Australia
CAE Pederson Ltd. (49%)	British Columbia
CAE Screenplates AB	Sweden
CAE Screenplates SA	France
ISDAT Simulation SDN BHD (20%)	Malaysia

[1] Partnership

[2] Partnership

SCHEDULE B – CAE'S AUDIT COMMITTEE MANDATE

ROLE AND MEMBERSHIP

The Audit Committee ("the Committee") shall be a committee to the Board of Directors.

The Committee shall consist of not fewer than four (4) such directors, one of whom shall be the Chairman of the Committee. All members of the Committee shall be independent directors, as determined by the Board taking into consideration applicable laws, regulations and other requirements applicable to such determination. Each member shall annually certify to CAE as to his or her independence, in form compliant with the standards of independence set out by regulatory authorities, stock exchanges and other applicable laws, regulations and requirements. Each member shall be able to read and understand financial statements (balance sheet, income statement, cash flow statement) that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by CAE's financial statements, or shall become able to do so within a reasonable period of time after joining the audit committee. One member shall have past employment in finance, accounting or any other comparable experience or background providing financial expertise. The Committee composition, including the qualifications of its members, shall comply with the requirements of regulatory authorities, stock exchanges and other applicable laws, regulations and requirements, as such requirements may be amended from time to time.

The Chairman of the Committee and its members shall be elected annually by the Board of Directors following recommendation of the Governance Committee and the Chairman of the Board. If the designated Chairman of the Committee is unable to attend a Committee meeting, the other Committee members present may elect a replacement Chairman for that meeting.

A majority of members of the Committee shall constitute a quorum.

RESPONSIBILITIES

Work closely and cooperatively with such officers and employees of CAE, its auditors, and/or other appropriate advisors and with access to such information as the Committee considers to be necessary or advisable in order to perform its duties and responsibilities, as assigned by the Board of Directors, in the following areas:

REVIEW OF AUDITED FINANCIAL STATEMENTS

1. Review the annual audited consolidated financial statements and make specific recommendations to the Board of Directors. As part of this process the Committee should:

- Review the appropriateness of and any changes to the underlying accounting principlesand practices.
- Review the appropriateness of estimates, judgments of choice and level of conservatismof accounting alternatives.

- Review financial risks, uncertainties, commitments and contingent liabilities and discusspolicies with respect to financial risk assessment and risk management.

ENGAGEMENT OF EXTERNAL AUDITORS

2. Recommend to the Board of Directors the appointment of the external auditor, which shall be accountable to the Board and the audit committee as representatives of the shareholders.

3. Review and approval of engagement letter. As part of this review the committee reviews and recommends to the Board of

Directors for their approval the auditors' fees for the annual audit. The Committee is responsible for the oversight of the work of the company's auditor for the purpose of preparing or issuing an audit report or related work, and the auditor shall report directly to the Committee. The Committee shall pre-approve the engagement of the external auditors for the audit, any audit-related services, advice with respect to taxation matters and other permitted services and fees for such services, including approval processes for any such service that comply with the requirements of regulatory authorities, stock exchanges and other applicable laws, regulations and requirements, as amended from time to time.

4. Receipt of a written statement not less than annually from the external auditor describing in detail all relationships between the auditor and CAE that may impact the objectivity and independence of the auditor. Review annually with the Board of Directors the independence of the external auditors and either confirm to the Board of Directors that the external auditors are independent in accordance with applicable listing requirements, laws, regulations and other rules, or recommend that the Board of Directors take appropriate action to satisfy itself of the external auditors' independence. Review and approve CAE's hiring policies regarding partners, employees and former partners and employees of the present and former external auditor of CAE.

REVIEW AND DISCUSSION WITH EXTERNAL AUDITORS

5. Review with the external auditors and management the annual external audit plans which would include objectives, scope, timing, materiality level and fee estimate.

6. Request and review an annual report prepared by the external auditors of any significant recommendations to improve internal control and corresponding management responses. Request and review an annual report prepared by the external auditors regarding the auditor's internal quality-control procedures, material issues raised by the most recent internal quality-control review of the auditors, or by any inquiry or investigation by governmental or professional authorities, within the preceding 5 years, respecting one or more audits carried out by the auditors, and any steps taken to deal with any such issues. Meet separately, periodically, with external auditors.

7. Make specific and direct inquiry of the external auditors relating to:

- Performance of management involved in the preparation of financial statements.
- Any restrictions on the scope of audit work.

- The level of cooperation received in the performance of the audit.
- The effectiveness of the work of internal audit.
- Any unresolved material differences of opinion or disputes between management and theexternal auditors, and be directly responsible for overseeing the resolution of disagreements between management and the external auditors regarding financial reporting.
- Any transactions or activities which may be illegal or unethical.
- Independence of the external auditor including the nature and fees of non-audit servicesperformed by external audit firm and its affiliates.
- Any other matter so desired.

REVIEW AND DISCUSSION WITH INTERNAL AUDITORS

8. Review the annual internal audit plan including assessment of audit risk, planned activities, level and nature of reporting, audit organization and annual budget. Meet separately, periodically, with internal auditors.

9. Make specific and direct inquiry of the internal auditors relating to:

• Any significant recommendations to improve internal control and corresponding

management responses.

- The level of independence of internal audit.
- Any material disagreement with management.
- Any other matter so desired.

REVIEW AND DISCUSSION WITH MANAGEMENT

10. Review and assess the adequacy and quality of organization and staffing for accounting and financial responsibilities as well as discuss with management the annual audited financial statements and quarterly financial statements and the independent auditor, including CAE's disclosures under Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A).

11. Review with management the annual performance of external and internal audit.

REVIEW OF OTHER PUBLIC DOCUMENTS

12. Ensure the Committee reviews all material public documents relating to CAE's financial performance, financial position or analyses thereon, including financial statements, MD&A, annual and interim earnings press releases and the Annual Information Form (AIF), prior to their release. Review and monitor practices and procedures adopted by the company to assure compliance with applicable listing requirements, laws, regulations and other rules, and where appropriate, make recommendations or reports thereon to the Board of Directors. Discuss CAE's financial information and earnings guidance, if any, provided to analysts and rating agencies.

13. Review significant changes in the accounting principles to be observed in the preparation of the accounts of the company and its subsidiaries, or in their application, and in financial disclosure presentation.

14. Prepare such reports of the Committee as may be required by any applicable securities regulatory authority to be included in the company's information circular or any other disclosure document of the company.

15. The Committee shall review and approve the procedures set out in the company's Corporate Communications & Disclosure Policy and will annually verify that adequate procedures exist within the company for the review of its disclosure of financial information derived from its financial statements.

OTHER RESPONSIBILITIES

16. The Board may refer from time to time such matters relating to the financial affairs of the company as the Board may deem appropriate.

MEETINGS

17. The Committee shall meet at such times as deemed necessary by the Board or the Committee and shall report regularly to the Board.

ENGAGEMENT OF PROFESSIONAL SERVICES

18. The Committee is authorized to engage independent counsel, and other advisers, as it determines necessary to carry out its duties. The company shall provide for appropriate funding, as determined by the Committee, for such services.

HANDLING OF COMPLAINTS

19. The Committee shall maintain procedures for the receipt, retention and treatment of complaints received by the company regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submission by employees of the company of concerns regarding questionable accounting or auditing matters.

ANNUAL REVIEW

20. The Committee shall review and assess the adequacy of its mandate annually, report to the Board of Directors thereon and recommend any proposed changes to the Board of Directors for approval. The Committee shall also perform an annual evaluation of the performance of the Committee and shall report to the Chairman of the Governance Committee of the CAE Board of Directors thereon.

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Management's Report on Internal Control Over Financial Reporting

Management of CAE is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f), 15d-15(f) under the Securities Exchange Act of 1934). CAE's internal control over financial reporting is a process designed under the supervision of CAE's President and Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with Canadian generally accepted accounting principles.

As of March 31, 2007, Management conducted an assessment of the effectiveness of the Company's internal control over financial reporting based on the framework and criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organization of the Treadway Commission. Based on this assessment, Management concluded that the Company's internal control over financial reporting as of March 31, 2007 was effective.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of March 31, 2007 has been audited

by PricewaterhouseCoopers LLP, an independent auditor.



R. E. Brown
President and Chief Executive Officer



A. Raquepas
Vice President
Chief Financial Officer

Montreal, Canada
May 31, 2007

Independent Auditors' Report

To the Shareholders of CAE Inc.

We have completed an integrated audit of the 2007 consolidated financial statements and internal control over financial reporting of CAE Inc. (the "Company") as of March 31, 2007 and audits of its 2006 and 2005 consolidated financial statements. Our opinions, based on our audits, are presented below.

Consolidated financial statements

We have audited the accompanying consolidated balance sheets of the Company as of March 31, 2007 and 2006, and the related consolidated statements of earnings, retained earnings and cash flows for each of the three years in the period ended March 31, 2007. These consolidated 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 audit of the Company's financial statements as of March 31, 2007 and for the year then ended in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). We conducted our audits of the Company's financial statements as of March 31, 2006 and for each of the two years in the period ended March 31, 2006 in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance about 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. We believe that our audits prov ide a reasonable basis for our opinion. In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of March 31, 2007 and 2006 and the results of its operations and its cash flows for each of the three years in the period ended March 31, 2007 in accordance with Canadian generally accepted accounting principles.

As described in note 1 to the consolidated financial statements, the Company has changed its accounting for stock-based compensation.

Internal control over financial reporting

We have also audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that the Company maintained effective internal control over financial reporting as of March 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testingand evaluatingthe designand operating effectiveness of internalcontrol, and performing such otherprocedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of March 31, 2007 is

fairly stated, in all material respects, based on criteria established in *Internal Control – Integrated Framework* issued by the COSO. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2007 based on criteria established in *Internal Control – Integrated Framework* issued by the COSO.

PricewaterhouseCoopers LLP

Chartered Accountants

May 30, 2007
Montreal, Quebec, Canada

Consolidated Balance Sheets

As at March 31

(amounts in millions of Canadian dollars)	**2007**	2006
		Restated (Note 1)
Assets		
Current assets		
Cash and cash equivalents	**$ 150.2**	$ 81.1
Accounts receivable (Note 6)	**219.8**	172.6
Inventories (Note 7)	**203.8**	180.9
Prepaid expenses	**23.5**	25.2
Income taxes recoverable	**24.7**	75.7
Future income taxes (Note 14)	**3.7**	5.7
	625.7	541.2
Property, plant and equipment, net (Note 8)	**986.6**	832.1
Future income taxes (Note 14)	**81.5**	78.2
Intangible assets (Note 9)	**36.0**	30.5
Goodwill (Note 10)	**96.9**	92.0
Other assets (Note 11)	**129.5**	136.2
Long-term assets held for sale (Note 4)	**–**	5.9
	$ 1,956.2	$ 1,716.1
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	**$ 403.9**	$ 373.7
Deposits on contracts	**184.8**	146.4
Current portion of long-term debt (Note 12)	**27.2**	10.4
Future income taxes (Note 14)	**4.9**	14.5
	620.8	545.0
Long-term debt (Note 12)	**256.0**	260.9
Deferred gains and other long-term liabilities (Note 13)	**232.7**	211.2
Future income taxes (Note 14)	**16.8**	26.8
	1,126.3	1,043.9
Shareholders' Equity		
Capital stock (Note 15)	**401.7**	389.0
Contributed surplus (Note 15)	**5.7**	5.6
Retained earnings	**510.2**	392.8
Cumulative translation adjustment (Note 16)	**(87.7)**	(115.2)
	829.9	672.2
	$ 1,956.2	$ 1,716.1

Contingencies and commitments (Notes 20 and 21)

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





R. E. Brown
Director

L. R. Wilson
Director

Consolidated Statements of Earnings

Years ended March 31

(amounts in millions of Canadian dollars, except per share amounts)		**2007**		2006		2005
				Restated (Note 1)		Restated (Note 1)
Revenue	**$**	**1,250.7**	$	1,107.2	$	986.2
Earnings (loss) before interest and income taxes (Note 27)	**$**	**189.4**	$	104.0	$	(372.9)
Interest expense, net (Note 12)		**10.6**		16.2		32.1
Earnings (loss) before income taxes	**$**	**178.8**	$	87.8	$	(405.0)
Income tax expense (recovery) (Note 14)		**49.7**		18.2		(100.6)
Earnings (loss) from continuing operations	**$**	**129.1**	$	69.6	$	(304.4)
Results of discontinued operations (Note 4)		**(1.7)**		(6.0)		104.8
Net earnings (loss)	**$**	**127.4**	$	63.6	$	(199.6)
Basic and diluted earnings (loss) per share from continuing operations	**$**	**0.51**	$	0.28	$	(1.23)
Basic earnings (loss) per share	**$**	**0.51**	$	0.25	$	(0.81)
Diluted earnings (loss) per share	**$**	**0.50**	$	0.25	$	(0.81)
Weighted average number of shares outstanding (basic) (Note 15)		**251.1**		249.8		247.1
Weighted average number of shares outstanding (diluted) (Note 15)		**253.0**		252.1		247.9

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

Consolidated Statements of Retained Earnings

Years ended March 31

(amounts in millions of Canadian dollars)		**2007**		2006		2005
Retained earnings at beginning of year, as previously reported	**$**	**395.7**	$	340.8	$	562.1
Change in accounting policy (Note 1)						
AcG-15		**–**		–		3.3
EIC-162		**(2.9)**		(1.6)		(1.9)
Retained earnings at beginning of year, restated	**$**	**392.8**	$	339.2	$	563.5
Net earnings (loss)		**127.4**		63.6		(199.6)
Dividends		**(10.0)**		(10.0)		(24.7)
Retained earnings at end of year	**$**	**510.2**	$	392.8	$	339.2

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

Consolidated Statements of Cash Flows

Years ended March 31

(amounts in millions of Canadian dollars)	**2007**	2006	2005
		Restated (Note 1)	Restated (Note 1)
Operating Activities			
Net earnings (loss)	**$ 127.4**	$ 63.6	$ (199.6)
Results of discontinued operations (Note 4)	**1.7**	6.0	(104.8)
Earnings (loss) from continuing operations	**129.1**	69.6	(304.4)
Adjustments to reconcile earnings to cash flows from operating activities:			
Impairment of goodwill, tangible and intangible assets (Note 5)	**–**	–	443.3
Depreciation	**55.0**	52.5	55.1
Amortization of deferred financing costs	**0.8**	2.2	7.2
Amortization and write down of intangible and other assets	**15.8**	22.9	19.7
Future income taxes	**(14.2)**	5.1	(114.1)
Investment tax credits	**19.3**	(11.8)	(29.2)
Stock-based compensation plans (Note 17)	**24.6**	12.2	5.5
Employee future benefit – net	**(0.9)**	(2.0)	0.9
Other	**(10.4)**	(3.9)	11.2
Changes in non-cash working capital (Note 19)	**20.2**	79.1	84.2
Net cash provided by continuing operating activities	**239.3**	225.9	179.4
Net cash provided by discontinued operating activities	**–**	2.1	21.6
Net cash provided by operating activities	**239.3**	228.0	201.0
Investing Activities			
Business acquisitions (net of cash and cash equivalents acquired) (Note 2)	**(4.4)**	2.6	(13.8)
Proceeds from disposal of discontinued operations (net of cash and cash equivalents disposed) (Note 4, 19)	**(3.8)**	(4.9)	239.4
Capital expenditures	**(158.1)**	(130.1)	(118.0)
Proceeds from sale and leaseback of assets	**–**	–	43.8
Deferred development costs	**(3.0)**	(1.8)	(9.9)
Deferred pre-operating costs	**(5.9)**	(0.7)	(1.7)
Other	**(2.9)**	(9.9)	4.2
Net cash (used in) provided by continuing investing activities	**(178.1)**	(144.8)	144.0
Net cash used in discontinued investing activities	**–**	(2.3)	(5.8)
Net cash (used in) provided by investing activities	**(178.1)**	(147.1)	138.2
Financing Activities			
Net borrowing under revolving unsecured credit facilities (Note 12)	**(0.6)**	(30.7)	(273.7)
Proceeds from long-term debt (Note 12)	**45.8**	32.1	3.4
Reimbursement of long-term debt (Note 12)	**(39.8)**	(65.7)	(50.5)
Dividends paid	**(9.8)**	(9.7)	(24.0)
Common stock issuance (Note 15)	**10.0**	8.0	3.6
Other	**(2.1)**	11.6	0.7
Net cash provided by (used in) continuing financing activities	**3.5**	(54.4)	(340.5)
Net cash provided by discontinued financing activities	**–**	1.2	3.2
Net cash provided by (used in) financing activities	**3.5**	(53.2)	(337.3)
Effect of foreign exchange rate changes on cash and cash equivalents	**4.4**	(8.1)	(2.3)
Net increase (decrease) in cash and cash equivalents	**69.1**	19.6	(0.4)
Cash and cash equivalents at beginning of year	**81.1**	61.5	61.9

Cash and cash equivalents at end of year	**$**	**150.2**	$	81.1	$ 61.5
Cash and cash equivalents related to:					
Continuing operations	**$**	**150.2**	$	81.1	$ 57.1
Discontinued operations (Note 4)		**–**		–	4.4
	$	**150.2**	$	81.1	$ 61.5

Supplementary Cash Flows Information (Note 19)

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Years ended March 31, 2007, 2006 and 2005 (amounts in millions of Canadian dollars)

NOTE 1 – NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS

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

The Company's operations are managed through four segments:

(i) Simulation Products/Civil – Designs, manufactures and supplies civil flight simulators, training devices and visual systems.

(ii) Simulation Products /Military – Designs, manufactures and supplies advanced military training products for air, land and sea applications.

(iii) Training & Services/Civil – Provides business and commercial aviation training and related services.

(iv) Training & Services/Military – Supplies military turnkey training and operational solutions, support services, life extensions, systems maintenance and modeling and simulation solutions.

Prior to fiscal 2006, the Company's operations were broken down into the following operating segments: Military Simulation & Training (Military), Civil Simulation & Training (Civil) and Marine Controls (Marine) until the latter's disposal in the fourth quarter of fiscal 2005.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND FINANCIAL STATEMENT PRESENTATION

The accounting policies of CAE Inc. and its subsidiaries conform, in all material respects, to Canadian generally accepted accounting principles (GAAP), as defined by the Canadian Institute of Chartered Accountants (CICA). In some respects, these accounting principles differ from United States generally accepted accounting principles (U.S. GAAP). The main differences are described in Note 28. Except where otherwise indicated, all amounts in these consolidated financial statements are expressed in Canadian dollars.

USE OF ESTIMATES

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

BASIS OF CONSOLIDATION

The consolidated financial statements include the accounts of CAE Inc. and of all its majority-owned subsidiaries, and variable interest entities for which the Company is the primary beneficiary. They also include the Company's proportionate share of assets, liabilities and earnings of joint ventures in which the Company has an interest (refer to Note 3). All significant intercompany accounts and transactions have been eliminated. Investments over which the Company exercises significant influence are accounted for using the equity method and portfolio investments are accounted for using the cost method.

On January 1, 2005, the Company adopted CICA Accounting Guideline -15 (AcG-15), *Consolidation of Variable Interest Entities*, on a retroactive basis without restatement of prior periods. AcG-15 provides a framework for identifying variable interest entities (VIEs) and for determining when an entity should include the assets, liabilities and results of operations of a VIE in its consolidated financial statements.

In general, a VIE is a corporation, partnership, limited-liability corporation, trust, or any other legal structure used to conduct activities or hold assets that either (1) has an insufficient amount of equity to carry out its principal activities without additional subordinated financial support, (2) has a group of equity owners that lack the power to make significant decisions about activities, or (3) has a group of equity owners that do not have the obligation to absorb losses or the right to receive returns generated by its operations.

AcG-15 requires a VIE to be consolidated if a variable interest holder (a party with an ownership, contractual or other financial interest in the VIE) is exposed to a majority of the risk of loss from the VIE's activities, is entitled to receive a majority of the VIE's residual returns (if no party is exposed to a majority of the VIE's losses), or both (the primary beneficiary). Upon consolidation, the primary beneficiary generally must initially record all of the VIE's assets, liabilities and non-controlling interests at fair value at the date the enterprise became the primary beneficiary. However, for variable interest entities created prior to the initial adoption of AcG-15, the assets, liabilities and non-controlling interests of these entities must be initially consolidated as if the entities were always consolidated based on the majority voting interest. AcG-15 also requires disclosures on VIEs that the variable interest holder is not required to consolidate, but in which it has a significant variable interest.

The adoption of AcG-15 on January 1, 2005 resulted in an increase in total assets, liabilities, and retained earnings of $46.9 million, $43.7 million, and $3.3 million, respectively and a decrease in the currency translation adjustment of $0.1 million in the fiscal 2005 consolidated financial statements (refer to Note 26).

REVENUE RECOGNITION

Multiple-element arrangements

The Company sometimes enters into multiple-element revenue arrangements, which may include a combination of design, engineering and manufacturing of flight simulators, spare parts and maintenance. A multiple-element arrangement are separated into more than one unit of accounting, and applicable revenue recognition criteria is considered separately for the different units of accounting if all of the following criteria are met:

(i) The delivered item has value to the customer on a stand-alone basis.

(ii) There is objective and reliable evidence of the fair value of the undelivered item (or items).

(iii) If the arrangement includes a general right of return related to the delivered item, delivery or performance of the undelivered item is considered probable and substantially in the control of the vendor.

The allocation of the revenue from a multiple deliverable agreement is based on fair value of an undelivered item as evidenced by the price of the item regularly charged by the Company on an individual basis or on other basis' covered by the concept of vendor-specific objective evidence as presented in the Statement of Position (SOP) 97-2, *Software Revenue Recognition* issued by the American Institute of Certified Public Accountants. The Company does enter into stand-alone transactions on a regular basis in regards to the sale of spare parts and maintenance arrangements, therefore the price charged when the elements are sold separately is readily available. The process for determining fair value of undelivered items, with respect to the design, engineering and manufacturing of flight simulators, entails evaluating each transaction and taking into account the unique features of each deal.

The applicable revenue recognition criteria for the separated units of accounting in regards to the individual design, engineering and manufacturing of flight simulators, spare parts and maintenance elements are described below.

Long-term contracts

Revenue from long-term contracts for the design, engineering and manufacturing of flight simulators is recognized using the percentage-of-completion method when there is persuasive evidence of an arrangement, when the fee is fixed or determinable and when collection is reasonably certain. Under this method, revenue and earnings are recorded as related costs are incurred, on the basis of the percentage of actual costs incurred to date, related to the estimated total costs to complete the contract. The cumulative impact of any revisions in cost and earnings estimates are reflected in the period in which the need for a revision becomes known. Provisions for estimated contract losses, if any, are recognized in the period in which the loss is determined. Contract losses are measured at the amount by which the estimated total costs exceed the estimated total revenue from the contract. Warranty provisions are recorded when revenue is recognized, based on past experience. Generally, no right of return or complementary upgrade is provided to customers. Post-delivery customer support is billed separately, and revenue is recognized over the support period.

Product maintenance

Revenue from maintenance contracts is recognized in earnings on a straight-line basis over the contract period. In situations when it is clear that costs will be incurred by using a basis other than a straight-line method, based on historical evidence, revenue is recognized over the contract period in proportion to the costs expected to be incurred in performing services under the contract.

Spare parts

Revenue from the sale of spare parts is recognized when there is persuasive evidence of an arrangement, delivery has occured, the fee is fixed or determinable and collection is reasonably assured.

NOTE 1 – NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Software arrangements

The Company also enters into software arrangements to sell, independently or in multiple-element arrangements, standalone software, services, maintenance and software customization. Revenue from software arrangements is recognized in accordance with the guidance set out SOP 97-2, as described in more detail as follows:

(i) Stand-alone products

Revenue from software license arrangements that do not require significant production, modification, or customization of software, is recognized when there is persuasive evidence of an arrangement, delivery has occurred, the fee is fixed or determinable and collection is reasonably assured.

(ii) Consulting services

Revenues arising from direct consulting or training services that are provided to customers are recognized as the services are rendered.

(iii) Maintenance

Maintenance and support revenues are recognized ratably over the term of the related agreements.

(iv) Multiple-element arrangements

The Company sometimes enters into multiple-element revenue software arrangements, which may include any combination of software, services or training, customization and maintenance. In such instances, the fee is allocated to the various elements as previously described.

(v) Long-term software arrangements

Revenues from fixed-price software arrangements and software customization contracts that require significant production, modification, or customization of software are also recognized under the percentage-of-completion method.

Training services

Training services are recognized when persuasive evidence of an arrangement exists, the fee is fixed or determinable, recovery is reasonably certain and the services have been rendered.

FOREIGN CURRENCY TRANSLATION

Self-sustaining foreign operations

Assets and liabilities of self-sustaining foreign operations are translated at exchange rates in effect at the balance sheet date and revenue and expenses are translated at the average exchange rates for the period. Foreign gains or losses arising from the translation into Canadian dollars are included in the cumulative translation adjustment account, which is a separate component of shareholders' equity. Accumulated amounts in the cumulative translation adjustment account are released to the Consolidated Statements of Earnings when the Company reduces its net investment in foreign operations by way of a reduction in capital or through the settlement of long-term intercompany balances, which had been considered part of the Company's net investment.

Foreign currency transactions

Monetary assets and liabilities denominated in currencies other than the functional currency are translated at the prevailing exchange rate at the balance sheet date. Non-monetary assets and liabilities denominated in currencies other than the functional currency and revenue and expense items are translated into the functional currency using the exchange rate prevailing at the dates of the respective transactions. Translation gains or losses are included in the determination of earnings, except those related to long-term intercompany account balances, which form part of the net investment in foreign operations, and those arising from the translation of foreign currency debt that has been designated as a hedge of the net investment in subsidiaries, which are included in the cumulative translation adjustment account.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of highly-liquid investments with original terms to maturity of 90 days or less.

ACCOUNTS RECEIVABLE

Receivables are recorded at fair value, net of a provision for doubtful accounts, based on expected recoverability. The Company is involved in a program under which it sells certain of its accounts receivable to a third party for a cash consideration without recourse to the Company. These transactions are accounted for when the Company is considered to have surrendered control over the transferred accounts receivable. Losses and gains on these transactions are recognized in net earnings (loss).

INVENTORIES

Raw materials are valued at the lower of cost and replacement cost. Spare parts to be used in the normal course of business 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.

Long-term contract inventories resulting from applying the percentage-of-completion method to account for revenues for most of the Company's long-term contracts have been reclassified from accounts receivable to be included as part of inventories and consist of materials, direct labour, relevant manufacturing overhead, and estimated contract margins.

LONG-LIVED ASSETS

Property, plant and equipment and amortization

Property, plant and equipment are recorded at cost less accumulated depreciation, net of any impairment charges. The declining balance and straight-line methods are used to calculate amortization over the estimated useful lives of the assets as follows:

	Method	Rates/ Years
Buildings and improvements	Declining balance / Straight-Line	5% – 10% / 10 to 20 years
Simulators	Straight-Line (10% residual)	Not exceeding 25 years
Machinery and equipment	Declining balance / Straight-Line	20% – 35% / 3 to 10 years

Asset retirement obligations

Asset retirement obligations are recognized in the period in which the Company incurs a legal obligation associated to the retirement of an asset. The obligation is measured initially at fair value discounted to its present value using a credit adjusted risk-free interest rate, and the resulting costs are capitalized into the carrying value of the related assets. The associated liability is accreted to the estimated fair value of the obligation at the settlement date through periodic accretion charges to earnings. Costs related to asset retirement obligations are depreciated over the remaining useful life of the underlying asset.

Leases

The Company enters into leases in which substantially all the benefits and risks of ownership 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 and straight-line over the term of the lease. Gains, net of transaction costs, related to the sale and leaseback of simulators are deferred and the net gains in excess of the residual value guarantees are amortized over the term of the lease. When at the time of the sale and leaseback transactions, the fair value of the asset is less than the carrying value; the difference is recognized as a loss in the Company's net earnings (loss) immediately. The residual value guarantees are ultimately recognized in the Company's net earnings (loss) upon expiry of the related sale and leaseback agreement.

Interest capitalization

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

Intangible assets with definite useful lives and amortization

Intangible assets with definite useful lives are recorded at their fair value at the acquisition date. Amortization is calculated using

the straight-line method for all intangible assets over their estimated useful lives as follows:

	Amortization period	Weighted average amortization period
Trade names	2 to 17 years	16
Customer relations	5 to 10 years	8
Customer contractual agreements	10 to 15 years	11
Enterprise resource planning and other software	5 to 7 years	6
Other intangible assets	5 to 20 years	12

Impairment of long-lived assets

Long-lived assets or asset groups are reviewed for impairment upon the occurrence of events or changes in circumstances indicating that the carrying value of the assets may not be recoverable, as measured by comparing its carrying amount to the estimated undiscounted future cash flows generated by their use and eventual disposal. Impairment, if any, is measured as the excess of the carrying amount of the asset or asset group over its fair value.

NOTE 1 – NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

OTHER ASSETS

Research and development costs

Research costs are charged to consolidated earnings (loss) in the period in which they are incurred. Development costs are also charged to consolidated earnings (loss) in the period incurred unless they meet all the criteria for deferral, as per CICA Handbook Section 3450, *Research and Development Costs*, and their recovery is reasonably assured. Government contribution arising from research and development activities is deducted from the related costs or assets, if deferred. Amortization of development costs deferred to future periods commences with the commercial production of the product and is charged to consolidated earnings (loss) based on anticipated sales of the product, when possible, over a period not exceeding five years using the straight-line method.

Pre-operating costs

The Company defers costs incurred during the pre-operating period for all new operations related to training centres. Pre-operating costs are incremental in nature and are considered by Management to be recoverable from the future operations of the new training centre. Capitalization ceases upon the opening of the training centre. Deferred pre-operating costs are amortized over a five–year period using the straight-line method.

Deferred financing costs

Costs incurred with the issuance of long-term debt are deferred and amortized on a straight-line basis over the term of the related debt. Costs related to sale and leaseback agreements are amortized on a straight-line basis over the term of the lease.

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.

BUSINESS COMBINATIONS AND GOODWILL

Acquisitions are accounted for using the purchase method and, accordingly, the results of operations of the acquired business are included in the Consolidated Statements of Earnings effective on their respective dates of acquisition.

Goodwill represents the excess of the cost of acquired businesses over the net of the amounts assigned to identifiable assets acquired and liabilities assumed. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate a potential impairment in value.

The impairment test consists of a comparison of the fair value of the Company's reporting units with their carrying amount. When the carrying amount of the reporting unit exceeds its fair value, the Company compares, in a second phase, the fair value of goodwill related to the reporting unit to its carrying value and recognizes, if required, an impairment loss equal to the excess. The fair value of a reporting unit is calculated based on one or more fair value measures, including present value techniques of estimated future cash flows and estimated amounts at which the unit, as a whole, could be purchased or sold in a current transaction between willing unrelated parties. If the carrying amount of the reporting unit exceeds its fair value, the second phase requires the fair value of the reporting unit to be allocated to the underlying assets and liabilities of that reporting unit, resulting in an implied fair value of goodwill. If the carrying amount of that re porting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss equal to the excess is recorded in consolidated net earnings (loss).

INCOME TAXES AND INVESTMENT TAX CREDITS

The Company uses the tax liability method to account for income taxes. Under this method, future income tax assets and liabilities are determined according to differences between the carrying value and the tax bases of assets and liabilities.

This method also requires the recognition of future tax benefits, such as net operating loss carry forwards, to the extent that the realization of such benefits is more likely than not. 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 tax assets and liabilities are measured by applying enacted or substantively enacted rates and laws at the date of the consolidated financial statements for the years in which the temporary differences are expected to reverse.

The Company does not provide for income taxes on undistributed earnings of foreign subsidiaries that are not expected to be repatriated in the foreseeable future.

Investment tax credits (ITCs) arising from research and development (R&D) activities are deducted from the related costs and are accordingly included in the determination of net earnings (loss) when there is reasonable assurance that the credits will be realized. ITCs arising from the acquisition or development 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 and ITCs recoverable involve certain uncertainties in the interpretation of complex tax regulations. Therefore, the Company provides for potential tax liabilities and ITCs recoverable based on Management's best estimates. Differences between the estimates and the ultimate amounts of taxes and ITCs are recorded in net earnings (loss) at the time they can be determined.

STOCK-BASED COMPENSATION PLANS

The Company's stock-based compensation plans consist of five individual plans: an Employee Stock Option Plan (ESOP), an Employee Stock Purchase Plan (ESPP), a Deferred Share Unit (DSU) plan for executives, a Long-Term Incentive Deferred Share Unit (LTI-DSU) plan and a Long-Term Incentive Restricted Share Unit (LTI-RSU) plan. All plans are described in Note 17.

Using the fair value method, compensation expense is measured at the grant date and recognized over the service period with a corresponding increase to contributed surplus in shareholders' equity. The Company estimates the fair value of options using the Black-Scholes option pricing model. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, valuation models generally require the input of highly-subjective assumptions including expected stock price volatility.

In Note 17, pro forma consolidated net earnings (loss) and pro forma basic and diluted net earnings (loss) 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.

A compensation expense is also recognized for the Company's portion of the contributions made under the ESPP and for the grant date amount of vested units at their respective valuations for the DSU, LTI-DSU and LTI-RSU plans. Any subsequent changes in the Company's stock price affect the compensation expense. Since fiscal 2004, the Company entered into an equity swap agreement with a major Canadian institution in order to reduce its cash and earnings exposure related to the fluctuation in the Company's share price relating to the DSU and LTI-DSU programs.

CAE's practice is to issue options in May of each fiscal year or at the time of hiring of new employees or new appointments. In both instances 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.

Since the adoption of Emerging Issues Committee (EIC)-162 in the third quarter of fiscal 2007, the Company recognizes the stock-based compensation expense for employees who will become eligible for retirement during the vesting period over the period from grant date to the date the employee becomes eligible to retire. In addition, if an employee is eligible to retire on the grant date, the compensation expense must be recognized at that date.

EMPLOYEE FUTURE BENEFITS

The Company maintains defined benefit pension plans that provide benefits based on length of service and final average earnings. The service costs and the pension obligations are actuarially determined using the projected benefit method prorated on employee service and Management's best estimate of expected plan investment performance, salary escalation and retirement ages of employees. For the purpose of calculating the expected return on plan assets, the relevant assets are valued at fair 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. Past service costs, arising from plan amendments, are deferred and amortized on a straight-line basis over the average remaining service live of active employees at the date of amendment.

When a curtailment arises, any unamortized past service costs associated with the reduction of future services is recognized immediately. Also, the increase or decrease in benefit obligations is recognized as a loss or gain, net of unrecognized actuarial gains or losses. Finally, when an event gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for prior to the settlement.

EARNINGS PER SHARE

Earnings per share are calculated by dividing consolidated net earnings (loss) available for common shareholders by the weighted average number of common shares outstanding during the year. The diluted weighted average number of common shares outstanding is calculated by taking into account the dilution that would occur if the securities or other agreements for the issuance of common shares were exercised or converted into common shares at the later of the beginning of the period or the issuance date unless it is anti-dilutive. The treasury stock method is used to determine the dilutive effect of the stock options. The treasury stock method is a method of recognizing the use of proceeds that could be obtained upon the exercise of options and warrants in computing diluted earnings per share. It assumes that any proceeds would be used to purchase common shares at the average market price during the period.

NOTE 1 – NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

DISPOSAL OF LONG-LIVED ASSETS AND DISCONTINUED OPERATIONS

Long-lived assets to be disposed of by sale are measured at the lower of their carrying amounts or fair value less selling costs and are not amortized as long as they are classified as assets to be disposed of by sale.

Operating results of a company's components disposed of by sale or being classified as held-for-sale are reported as discontinued operations if the operations and cash flows of those components have been, or will be, eliminated from the Company's current operations pursuant to the disposal and if the Company does not have significant continuing involvement in the operations of the component after the disposal transaction. A component of an enterprise includes operations and cash flows that can be clearly distinguished, operationally and for financial reporting

purposes, from the rest of the Company's operations and cash flows.

HEDGING RELATIONSHIPS AND DERIVATIVE FINANCIAL INSTRUMENTS

The Company enters into forward, swap and option contracts to reduce the financial risk related to its exposure to fluctuations in interest rates and foreign exchange rates. The interest rate risk associated with certain long-term debt is hedged through interest rate swaps. The foreign currency risk associated with certain purchase and sales commitments denominated in a foreign currency is hedged through a combination of forward contracts and options. The Company does not use any derivative financial instruments for trading or speculative purposes.

Effective April 1, 2004, the Company prospectively adopted CICA Accounting Guideline (AcG) AcG-13, *Hedging Relationships* and CICA Emerging Issues Committee Abstract 128 (EIC-128), *Accounting for Trading, Speculative or Non-Hedging Derivative Financial Instruments* . AcG-13 addresses 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. EIC-128 deals with the issue of how to account for a freestanding derivative financial instrument that gives rise to a financial asset or liability and does not qualify for hedge accounting. The adoption of this guideline and abstract did not have a material impact on the Company's Consolidated Financial Statements.

Gains and losses on foreign currency contracts designated as effective as hedges are recognized in the Consolidated Statements of Earnings during the same period as the underlying revenues and expenses. For interest rate swaps, the difference between the swap rate and the actual rate is reflected against the related interest expense. 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.

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 Consolidated Balance Sheets and recognized in earnings (loss) in the period in which the underlying hedged transaction is recognized. In the event a designated hedged item is sold, extinguished or matured prior to the termination of the related derivative instrument, any realized or unrealized gain or loss on such derivative instrument is recognized in earnings (loss). Interest payments relating to swap contracts are recorded in net earnings (loss) over the life of the underlying transaction using the accrual method as an adjustment to interest income or interest expense.

GOVERNMENT COST SHARING

Contributions from Industry Canada under the Technology Partnerships Canada program (TPC) and from Investissement Québec for costs incurred in research and development (R&D) programs, are recorded as a reduction of costs or as a reduction of capitalized costs. A liability to repay the government contribution is recognized when conditions arise. The repayment thereof is reflected in the consolidated statements of earnings when royalties become due.

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

In accordance with 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)*, the Company recognizes severance benefits that do not vest when the decision is made to terminate the employee. Special termination benefits are accounted for when Management commits to a plan that specifically identifies all significant actions to be taken and commits the entity to the event that obligates it under the terms of the contract with its employees to pay such termination benefits. Such termination benefits and the benefit arrangement are communicated to the employees in sufficient detail to enable them to determine the type and amount of benefits they will receive when their employment is terminated. All other costs associated with restructuring, exit and disposal activities are recognized in the period in which they are incurred and measured at their fair value. CAE has applied these guidelines for severance termination benefits and other restructuring costs as described in Note 25.

DISCLOSURE OF GUARANTEES

The Company discloses information concerning certain types of guarantees that may require payments, contingent on specified types of future events. In the normal course of business, CAE issues letters of credit and performance guarantees.

CHANGE IN ACCOUNTING POLICY

EIC-162: Stock-Based Compensation for Employees Eligible to Retire Before the Vesting Date

During the third quarter of fiscal 2007, the Company adopted EIC-162, *Stock-Based Compensation for Employees Eligible to Retire Before the Vesting Date*. This abstract stipulates that the stock-based compensation expense for employees who will become eligible for retirement during the vesting period be recognized over the period from grant date to the date the employee becomes eligible to retire. In addition, if an employee is eligible to retire on the grant date, the compensation expense must be recognized at that date. The abstract requires retroactive restatement of prior periods.

The impact, in these consolidated financial statements, of adopting EIC-162 is an increase to contributed surplus by $0.2 million on April 1, 2005 and a decrease to contributed surplus by $0.2 million on April 1, 2006. Also, the adoption of the abstract resulted in a cumulative charge of $1.9 million to retained earnings on April 1, 2004, $1.6 million on April 1, 2005 and $2.9 million on April 1, 2006. In addition, the Company was impacted by a $2.2 million increase to the stock-based compensation expense for the fiscal year ended March 31, 2006 and $0.1 million decrease for the fiscal year ended March 31, 2005. This standard had a $0.01 and a nil impact on the basic and diluted earnings per share for the fiscal years ending March 31, 2006, and March 31, 2005 respectively.

FUTURE CHANGES TO ACCOUNTING STANDARDS

Financial instruments – recognition and measurement, hedges and comprehensive income

In January 2005, the Accounting Standards Board (AcSB) issued three new standards dealing with financial instruments: (i) Financial Instruments – Recognition and Measurement; (ii) Hedges; and (iii) Comprehensive Income. These sections are required for public companies for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006.

CICA Handbook Section 3855, *Financial Instruments – Recognition and Measurement* prescribes when a financial instrument should be recognized on the balance sheet and the measurement method, using fair value. It also specifies how financial instrument gains and losses should be presented.

CICA Handbook Section 3865, *Hedges* allows optional treatment providing that hedges be designated as either fair value hedges, cash flow hedges or hedges of a net investment in a self-sustaining foreign operation. For a fair value hedge, the gain or loss attributable to the hedged risk is recognized in net income in the period of change together with the offsetting loss or gain on the hedged item attributable to the hedged risk. The carrying amount of the hedged item is adjusted for the hedged risk. For a cash flow hedge or for a hedge of a net investment in a self-sustaining foreign operation, the effective portion of the hedging item's gain or loss is initially reported in Other Comprehensive Income and subsequently reclassified to net income when the hedged item affects net income.

CICA Handbook Section 1530, *Comprehensive Income*, and has amended Section 3250, *Surplus*, by renaming it Section 3251, *Equity*. These standards require enterprises to present comprehensive income and its components as well as net income in its financial statements and to separately present changes in equity during the period as well as components of equity at the end of the period, including comprehensive income.

The Company is currently evaluating the impact of this new standard.

Financial instrument – disclosures and presentation

In April 2005, the AcSB issued CICA Handbook Section 3861, *Financial instruments – Disclosure and presentation*. This section establishes standards for presentation of financial instruments and non-financial derivatives and identifies information that should be disclosed about them. This section applies to fiscal years beginning on or after October 1, 2006. In December 2006, the AcSB issued CICA Handbook Section 3862, *Financial instruments – Disclosures* and Section 3863, *Financial instruments – Presentation*. These standards revise Section 3861. Under these new sections, entities will be required to disclose information that enables users to evaluate the significance of a financial instrument to an entity's financial position and performance. These sections apply to fiscal years beginning on or after October 1, 2007. The Company is currently evaluating the impact of this new standard.

NOTE 1 – NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

Accounting changes

In 2006, the CICA has issued a new section of the CICA Handbook, Section 1506, *Accounting Changes*. The application of this section is required for public companies for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2007. This new section establishes criteria for changes in accounting policies, along with the accounting treatment and disclosure regarding changes in accounting policies, estimates and correction of errors. This standard will be applied prospectively beginning April 1, 2007. The Company is currently evaluating the impact of this new standard.

Capital disclosure

In December 2006, the AcSB issued Handbook Section 1535, *Capital Disclosures*, which establishes guidelines for the disclosure of information regarding an entity's capital and how it is managed. This standard requires disclosure of an entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital and whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. This standard is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The Company is currently evaluating the impact of this new standard.

Inventories

In March 2007, the AcSB approved new Section 3031, *Inventories*, which will replace existing Section 3030 with the same title. The new Section establishes that inventories should be measured at the lower of cost and net realizable value, with guidance on the determination of cost, including allocation of overheads and other costs to inventory and requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The final standard is expected to be issued by mid 2007 effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The Company is currently evaluating the impact of this new standard.

NOTE 2 – BUSINESS ACQUISITIONS AND COMBINATIONS

KESEM INTERNATIONAL PTY LTD

On December 22, 2006, the Company acquired all the issued and outstanding shares of Kesem International Pty Ltd (Kesem), which offers a range of professional services to support design, analysis and experimentation in the defence and homeland security markets. Total consideration for this acquisition, excluding acquisition costs of $0.3 million, amounted to AUD$5.0 million ($4.6 million) payable in cash in four instalments as follows:

(i) AUD$3.5 million ($3.1 million) at closing date

(ii) AUD$0.5 million ($0.5 million) in fiscal 2007

(iii) AUD$0.5 million ($0.5 million) in fiscal 2008

(iv) AUD$0.5 million ($0.5 million) in fiscal 2009.

During the fourth quarter of fiscal 2007, the parties have agreed to the distributable working capital adjustment and no significant adjustment was required.

As outlined in the purchase agreement, $1.0 million of the purchase price, paid by CAE on the acquisition date, shall be held in a trust account until the respective instalment date. The last two instalments are subject to adjustments based on the level of revenue for the period ending June 2007 and on the value of awarded contracts for the period ending December 2007. Any changes in the total consideration will be accounted for as a change in goodwill.

The acquisition was accounted for under the purchase method and the operating results have been included from its acquisition date. The allocation of the purchase price is based on Management's best estimate of the fair value of assets and liabilities. Allocation involves a number of estimates as well as the gathering of information over a number of months.

TERRAIN EXPERTS INC.

On May 20, 2005, the Company acquired all the issued and outstanding shares of Terrain Experts Inc. (Terrex), which develops software tools for terrain database generation and visualization. Total consideration for this acquisition was $11.1 million ($14.0 million) payable in common shares issued by CAE and a nominal cash portion in three instalments as follows:

(i) 1,000,000 shares representing US$4.8 million (approximately $6.1 million issued at a price of $6.13 per share, the closing price of the common shares on the Toronto Stock Exchange (TSX) on May 20, 2005), and US$0.2 million ($0.3 million) together in cash representing US$5.0 million ($6.4 million) at the closing date.

(ii) US$3.6 million through the issuance of CAE shares in fiscal 2007 (twelve months following the closing of the acquisition) to be calculated at the TSX stock price on the date of issuance. During fiscal 2007, the Company settled the second instalment of the payment related to the acquisition in the amount of US$3.6 million with cash rather than shares.

(iii) US$2.5 million through the issuance of CAE shares in fiscal 2008 (twenty four months following the closing of the transaction) to be calculated at the TSX stock price on the date of issuance.

During fiscal 2007, the Company completed the purchase price allocation for this acquisition, and no adjustments were required.

CAE PROFESSIONAL SERVICES (CANADA) INC. (FORMERLY IDENTIFIED AS GREENLEY & ASSOCIATES INC.)

On November 30, 2004, the Company acquired all the issued and outstanding shares of CAE Professional Services (Canada) Inc. (formerly Greenley & Associates Inc. [G&A]), which provides services in the areas of project management, human factors, modelling and simulation. Total consideration for this acquisition amounted to $4.4 million payable in equivalent common shares issued by CAE in four instalments as follows: 424,628 shares (representing $2.0 million) at the closing date; $0.8 million in fiscal 2006; $0.8 million in fiscal 2007; and 169,851 shares (representing $0.8 million at the transaction date) to be issued on November 30, 2007. The number of shares issued (to be issued) to satisfy the first and the fourth payments was calculated based on the average closing share price ($4.71 per share) of CAE common shares on the TSX for the 20-day period ending two days prior to November 30, 2004. The 91,564 shares issued to satisfy the second payment was based on the average closing share price of CAE common shares on the TSX for the 20-day period ending two days before the date of issuance ($8.07 per share). The third payment of $0.8 million was initially considered to be satisfied through the issuance of shares based on the average closing share price of CAE common shares on the TSX for the 20-day period ending two days before the date of issuance. However, during fiscal 2007, the Company settled the third payment with cash rather than shares. During the second quarter of fiscal 2006, the Company completed the purchase price allocation for this acquisition, and no adjustments were required.

SERVICIOS DE INSTRUCCION DE VUELO, S.L

In February 2004, CAE and Iberia Lineas Aereas de España, SA (Iberia) agreed to combine their aviation training operations in Spain after receiving regulatory clearance from the Spanish authorities to commence operations, under an agreement entered into in October 2003.

On May 27, 2004, in connection with the financing of the combined operations, CAE Servicios Globales de Instruccion de Vuelo (España), S.L. (SGIV), a wholly-owned subsidiary of CAE, and Iberia contributed the net assets of their respective training centre facilities to Servicios de Instruccion de Vuelo, S.L. (SIV), with SGIV obtaining ownership of 80% of SIV. SIV financed the acquisition of the assets from SGIV and Iberia through an asset-backed financing transaction (refer to Note 12).

As part of this transaction, should the October 2003 agreement be terminated, SGIV and Iberia will be obliged to repurchase the assets they contributed, in proportion to the fair market value of the assets, for a total amount equal to the outstanding balance under the financing transaction.

As part of the May 27, 2004 agreement (the Agreement), Iberia was to subsequently transfer a simulator that it was leasing from a third party to SIV in exchange for a cash consideration of $5.7 million (E3.5 million). This transaction was accounted for as an increased contribution of property, plant and equipment and in long-term debt with a cash consideration equivalent to the net asset value.

In addition, as part of the Agreement, SIV has agreed to fund an amount up to a maximum of $2.4 million (E1.5 million) to cover any payments made by Iberia to former employees in order to indemnify Iberia for potential costs to be incurred due to certain employment matters. Based on Management's best estimate of SIV's potential liability, an amount of $2.4 million (E1.5 million) has been accrued as part of the purchase price and accounted for as goodwill.

FLIGHT TRAINING CENTRE CHILE S.A.

On April 22, 2004, the Company acquired all the issued and outstanding shares of Flight Training Centre Chile S.A. (FTC Chile, located in Santiago, Chile) from LAN Chile S.A. for total cash consideration of $0.9 million (US$0.7 million). The balance of the purchase price was paid in two instalments of US$0.3 million in fiscal 2006 and US$0.8 million in fiscal 2007. This acquisition expanded the Company's pilot-training operations into the South American market.

NOTE 2 – BUSINESS ACQUISITIONS AND COMBINATIONS (CONT'D)

The net assets contributed by Iberia to SIV and net assets acquired from Kesem, Terrex, G&A and FTC Chile are summarized as follows:

	2007	2006				2005
(amounts in millions)	**Kesem**	Terrex	G&A	SIV	FTC Chile	Total
Current assets[1]	**$ 0.9**	$ 1.9	$ 2.1	$ 4.6	$ 0.2	$ 6.9
Current liabilities	**(1.1)**	(2.1)	(1.2)	(0.1)	(0.1)	(1.4)
Property, plant and equipment	**0.1**	0.3	0.3	73.1	2.2	75.6
Other assets	**–**	3.3	0.5	–	–	0.5
Intangible assets						
Trade names	**0.1**	0.3	0.3	–	–	0.3
Technology	**0.1**	1.6	–	–	–	–
Customer relations	**0.6**	0.8	0.5	7.2	–	7.7
Other intangibles	**–**	–	0.1	–	–	0.1
Goodwill[2]	**4.1**	4.5	2.5	6.9	–	9.4
Future income taxes	**(0.2)**	0.5	(0.5)	–	0.4	(0.1)
Long-term debt	**–**	–	(0.2)	(61.8)	–	(62.0)
Long-term liabilities	**(0.2)**	–	–	(2.4)	(0.3)	(2.7)
Fair value of net assets acquired, excluding cash position at acquisition	**4.4**	11.1	4.4	27.5	2.4	34.3
Cash position at acquisition	**0.5**	2.9	–	–	–	–
Fair value of net assets acquired	**4.9**	14.0	4.4	27.5	2.4	34.3
Less: Balance of purchase price	**–**	–	–	–	(1.5)	(1.5)
Issuance of 1,000,000 shares (Note 15)	**–**	(6.1)	–	–	–	–
Issuance of 424,628 shares (Note 15)	**–**	–	(2.0)	–	–	(2.0)
Shares to be issued[3]	**–**	(7.6)	(2.4)	–	–	(2.4)
Non-controlling interest	**–**	–	–	(14.6)	–	(14.6)
Total cash consideration[4]:	**$ 4.9**	$ 0.3	$ –	$ 12.9	$ 0.9	$ 13.8

(1) Excluding cash on hand

(2) This goodwill is not deductible for tax purposes

(3) Has been accounted for as a liability pending issuance

(4) The total cash consideration for the acquisition of Kesem includes acquisition costs of $0.3 million

The net assets of Kesem are included in the Training & Services/Military segment. The net assets of Terrex are included in the Simulation Products/Military segment. The net assets of G&A are included in the Training & Services/Military segment. The net assets of SIV and FTC are included in Training & Services/Civil segment.

NOTE 3 – INVESTMENT IN JOINT VENTURES

The Company's consolidated balance sheets and consolidated statements of earnings and cash flows as at March 31, 2007 and for the year then ended include, on a proportionate consolidation basis, the impact of its joint venture companies of Zhuhai Xiang Yi Aviation Technology Company Limited – 49%, Helicopter Training Media International GmbH – 50%, Helicopter Flight Training Services GmbH – 25%, and since October 4, 2006, the Emirates-CAE Flight Training center – 50%.

The Company's consolidated balance sheets and consolidated statements of earnings and cash flows include, on a proportionate consolidation basis, the impact of its joint venture companies of Zhuhai Xiang Yi Aviation Technology Company Limited – 49%, Helicopter Training Media International GmbH – 50%, and Helicopter Flight Training Services GmbH – 25% as at March 31, 2006, and for the year then ended but only includes the joint venture company of Zhuhai Xiang Yi Aviation Technology Company Limited – 49% for the fiscal year ending March 31, 2005.

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

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

(amounts in millions)		**2007**		2006		2005
Assets						
Current assets	**$**	**24.5**	$	22.0	$	8.1
Property, plant and equipment and other non-current assets		**159.4**		42.7		17.6
Liabilities						
Current liabilities		**12.0**		10.9		1.3
Long-term debt (including current portion)		**59.2**		26.2		–
Earnings						
Revenue	**$**	**50.0**	$	42.0	$	10.8
Net earnings		**6.8**		4.0		3.7
Segmented operating income						
Simulation Products/Military		**1.4**		(0.2)		–
Training and Services/Civil		**7.5**		5.2		4.1
Training and Services/Military		**(0.2)**		(0.5)		–
Cash flows from (used in):						
Operating activities	**$**	**4.6**	$	12.2	$	5.8
Investing activities		**(39.2)**		(26.5)		(14.0)
Financing activities		**29.9**		26.3		(0.1)

NOTE 4 – DISCONTINUED OPERATIONS AND LONG-TERM ASSETS HELD FOR SALE

DISCONTINUED OPERATIONS

Marine Controls

On February 3, 2005, the Company completed the sale of the substantial components of the Marine Controls segment to L-3 Communications Corporation (L-3), for a cash consideration of $238.6 million. This amount was subject to the approval by L-3 of the net working capital of the Marine Controls segment. The parties have completed the discussions regarding the net working capital in the second quarter of fiscal 2007 and L-3 was paid for the difference in the net working capital. The Company received from L-3 in fiscal 2007, notices of claims for indemnification pursuant to the Sale and Purchase Agreement (SPA), including in respect of allegations that the Company was in breach of certain representations and warranties in the SPA. At this time, neither the outcome of these matters nor the potential future payments, if any, are determinable. The Company intends to assert all available defences against these claims. The aggregate liability for claims made under the SPA is limited to US$25 million.

During the second and third quarters of fiscal 2006, in accordance with the purchase agreement, L-3 acquired the two components of the Marine Controls segment that were subject to regulatory approvals, and assumed the Company's guarantee of $53.0 million (£23 million) of project-financed related debt for the U.K. Astute Class submarine training program.

The results of the Marine Controls segment have been reported as discontinued operations since the second quarter of fiscal 2005 and have been reclassified in previously reported statements. Interest expense relating to debt not directly attributable to the continuing operations and paid with the proceeds of the sale of the Marine Controls business has been allocated to discontinued operations based on its share of net assets.

Cleaning Technologies and other discontinued operations

In fiscal 2004, the Company completed the sale of its last Cleaning Technologies business, Alpheus Inc., to Cold Jet Inc. The Company was entitled to receive further consideration based on the performance of the business until 2007 and also had certain obligations to Cold Jet Inc.

During fiscal 2006, an agreement was reached to settle the further consideration and cancel the outstanding obligations of the Company. Cold Jet paid the Company an amount of $0.2 million.

During the second quarter of fiscal 2007, the Company received early payment, in full, of $9.3 million in secured subordinated promissory long-term notes previously recorded in other assets. These notes, with a carrying value of $7.9 million, were received by the Company as part of the consideration for its sale in 2002 of Ultrasonics and Ransohoff. The repayment resulted in the recognition of $1.4 million of interest revenue during the second quarter due to the accretion of discounts on the long-term notes receivable. The parties have also concluded discussions regarding adjustments to working capital provisions. As a result of these discussions, the Company collected and recorded an additional amount of approximately $0.1 million (net of tax recovery of $0.1 million). Also, during fiscal 2006, the Company incurred additional costs of $3.4 million related to its former Cleaning Technologies business mostly in connection with the revaluation of a pension liability and the reversal of an unrecognized tax asset, and recorded $0.9 million for other discontinued operations.

NOTE 4 – DISCONTINUED OPERATIONS AND LONG-TERM ASSETS HELD FOR SALE (CONT'D)

Forestry Systems

On May 2, 2003, the Company completed the sale of one of its Forestry Systems businesses to Carmanah Design and Manufacturing. The Company was entitled to receive further consideration based on the performance of the business. During the first quarter of fiscal 2007, a settlement was concluded and the Company received a payment of $0.2 million (net of tax expense of $0.1 million). On August 16, 2002, the Company sold substantially all the assets of the sawmill division of its Forestry Systems. The Company was entitled to receive further cash consideration from the sale based on operating performance of the disposed business for the three-year period from August 2002 to August 2005. In November 2005, the Company was notified by the buyers that, in their view, the targeted level of operating performance which would trigger further payment had not been achieved. The Company has completed a review of the buyers' books and records and has, in January 2006, launched legal proceedings to collect the payment that it believes is owed to the Company. During the fourth quarter of fiscal 2007, the Company recognized fees in connection with the evaluation and litigation exercise amounting to $0.9 million (net of tax recovery of $0.2 million). For fiscal 2006, the Company incurred $0.2 million (net of tax recovery of $0.1 million). In fiscal 2005, no such fees were incurred. This dispute has currently been referred to arbitration and is in the discovery of evidence phase.

LONG-TERM ASSETS HELD FOR SALE

As part of its global expansion, the Company announced in its third quarter of fiscal 2005 that it would be opening a new business aviation training centre in Morris County, New Jersey. The new training centre became operational in fiscal 2007. As a result, the valuation of two redundant training centre buildings, one located in Dallas, Texas and a second located in Marietta, Georgia, were adjusted to their fair value in fiscal 2005 and reclassified as assets held for sale, and previously reported amounts have been reclassified. Also, as part of a review of its performance and strategic orientation, the Company decided to close its training centre located in Maastricht, Netherlands during the third quarter of fiscal 2006. As a result, property was reclassified as assets held for sale.

In the second quarter of fiscal 2007, the Company sold for $3.6 million the aggregate land and building in Dallas, Texas and Marietta, Georgia, which was previously reported as being held for sale. As a result of this transaction, the Company recorded a loss on the sale of $0.2 million (net of tax recovery of $0.1 million).

During the last quarter of fiscal 2007, the Company sold the remaining long-term assets held for sale in Maastricht, Netherlands for $2.8 million. As a result of this transaction, the Company recorded a net gain on the sale of $0.2 million (net of tax expense of $0.1 million). Summarized financial information for the discontinued operations is as follows:

SUMMARY OF DISCONTINUED OPERATIONS

(amounts in millions, except per share amounts)	**2007**	2006	2005
Revenue			
Marine Controls	**$ –**	$ –	$ 109.6
	$ –	$ –	$ 109.6
Gain on sale of Marine Controls, net of $25.1 tax expense	**$ –**	$ –	$ 103.9
Net (loss) earnings from Marine Controls, 2007 – net of tax recovery of $0.2; 2006 – net of tax expense of $0.7; 2005 – net of tax expense of $3.8	**(1.1)**	(1.7)	5.5
Net earnings (loss) from Cleaning Technologies and other discontinued operations, 2007 – net of tax recovery of $0.1; 2006 – net of tax expense of $1.0; 2005 – net of tax expense of Nil	**0.1**	(4.1)	(4.4)
Net loss from Forestry Systems, 2007 – net of tax recovery of $0.1; 2006 – net of tax recovery of $0.1; 2005 – net of tax expense of Nil	**(0.7)**	(0.2)	–
Net loss from Training & Services/Civil, 2007 – net of tax expense of Nil ; 2006 – net of tax			

expense of Nil; 2005 – net of tax recovery of $0.1	**–**	–	(0.2)
Net (loss) earnings from discontinued operations	**$ (1.7)**	$ (6.0)	$ 104.8
Basic and diluted net (loss) earnings per share from discontinued operations	**$ (0.01)**	$ (0.02)	$ 0.42

NOTE 5 – IMPAIRMENT OF GOODWILL, TANGIBLE AND INTANGIBLE ASSETS

During fiscal 2005, CAE's management performed a comprehensive review of the current performance and strategic orientation of its reporting units. This strategic review revealed that several factors had severely and persistently affected mainly the civil business, including the enduring adverse economic environment of the airline industry. This created a new market reality, slower than anticipated training outsourcing opportunities (due to pilot-related restructuring efforts at some major airlines), escalating cost of manufacturing full-flight simulators, the erosion of the 30 to 50-seat regional jet market and the appreciation of the Canadian dollar. These elements had caused the recalibration of some key assumptions in civil's strategic planning, which led to the review of the carrying amount of certain assets, including goodwill, intangible assets acquired in previous acquisitions, inventory levels for the regional jet market, non-performing training eq uipment and certain other assets.

Therefore, based on this review, as at March 31, 2005, the Company recorded a $443.3 million impairment charge, all of which is virtually related to its civil segments, as follows:

(amounts in millions)	2005
Goodwill	$ 205.2
Customer relations	86.7
Trade names and other intangible assets	20.4
Property, plant and equipment (simulators)	78.4
Inventories	33.3
Other assets	19.3
	$ 443.3

NOTE 6 – ACCOUNTS RECEIVABLE

(amounts in millions)	**2007**	2006
Trade	**$ 136.2**	$ 107.2
Allowance for doubtful accounts	**(4.4)**	(4.8)
Accrued receivables	**45.7**	35.1
Other receivables	**42.3**	35.1
	$ 219.8	$ 172.6

The Company has an agreement to sell third-party receivables to a financial institution for an amount of up to $35.0 million. Under the terms and conditions of the agreement, the Company continues to act as a collection agent. The selected accounts receivable are sold to a third party for a cash consideration on a non-recourse basis to the Company. As at March 31, 2007, $29.0 million (2006 - $6.7 million) of specific accounts receivable were sold to the financial institution pursuant to this agreement. Proceeds (net of $0.6 million in fees, 2006 - $0.5 million) of the sale were used to repay borrowings under the Company's credit facilities.

NOTE 7 – INVENTORIES

(amounts in millions)	**2007**	2006
Long-term contracts	**$ 112.7**	$ 87.7
Work in progress	**66.1**	66.6
Raw materials, supplies and manufactured products	**25.0**	26.6
	$ 203.8	$ 180.9

NOTE 8 – PROPERTY, PLANT AND EQUIPMENT

(amounts in millions)	**2007**			2006		
	Cost	**Accumulated depreciation**	**Net book value**	Cost	Accumulated depreciation	Net book value
Land	**$ 21.2**	**$ –**	**$ 21.2**	$ 20.2	$ –	$ 20.2
Buildings and improvements	**238.9**	**72.6**	**166.3**	220.6	65.8	154.8
Simulators	**645.5**	**92.4**	**553.1**	528.5	77.9	450.6
Machinery and equipment	**185.0**	**117.3**	**67.7**	169.0	103.4	65.6
Assets under capital lease [(1)]	**34.4**	**22.6**	**11.8**	32.2	20.3	11.9
Assets under construction	**166.5**	**–**	**166.5**	129.0	–	129.0
	$ 1,291.5	**$ 304.9**	**$ 986.6**	$ 1,099.5	$ 267.4	$ 832.1

[(1)] Includes simulators and machinery and equipment.

The average remaining amortization period for the simulators is 14 years.

NOTE 9 – INTANGIBLE ASSETS

(amounts in millions)	**2007**			2006		
	Cost	**Accumulated amortization**	**Net book value**	Cost	Accumulated amortization	Net book value
Trade names	**$ 12.2**	**$ 1.7**	**$ 10.5**	$ 12.2	$ 0.9	$ 11.3
Customer relations	**1.7**	**0.3**	**1.4**	1.2	0.2	1.0
Customer contractual agreements	**7.6**	**2.9**	**4.7**	7.7	3.0	4.7
Enterprise resource planning – (ERP) and other software	**20.7**	**3.9**	**16.8**	12.0	1.5	10.5
Other intangible assets	**4.9**	**2.3**	**2.6**	4.0	1.0	3.0
	$ 47.1	**$ 11.1**	**$ 36.0**	$ 37.1	$ 6.6	$ 30.5

The continuity of intangible assets is as follows:

(amounts in millions)	**2007**	2006
Opening balance	**$ 30.5**	$ 27.9
Acquisitions (Note 2)	**0.8**	2.7
ERP and other software additions	**8.8**	3.9
Amortization	**(3.8)**	(3.2)
Foreign exchange	**(0.3)**	(0.8)
Closing balance	**$ 36.0**	$ 30.5

The annual amortization expense for the next five years will be approximately $3.8 million.

NOTE 10 – GOODWILL

(amounts in millions)	**2007**				
	Simulation Products/Civil	**Training Services/Civil**	**Simulation Products/Military**	**Training Services/Military**	**Total**

Opening balance	**$**	**–**	**$**	**–**	**$**	**54.2**	**$**	**37.8**	**$**	**92.0**
Acquisitions (Note 2)		**–**		**–**		**–**		**4.1**		**4.1**
Foreign exchange		**–**		**–**		**0.4**		**0.4**		**0.8**
Closing balance	**$**	**–**	**$**	**–**	**$**	**54.6**	**$**	**42.3**	**$**	**96.9**

(amounts in millions)	2006				
	Simulation Products/Civil	Training Services/Civil	Simulation Products/Military	Training Services/Military	Total
Opening balance[(1)]	$ –	$ –	$ 52.5	$ 39.6	$ 92.1
Acquisitions (Note 2)	–	–	4.5	–	4.5
Foreign exchange	–	–	(2.8)	(1.8)	(4.6)
Closing balance	$ –	$ –	$ 54.2	$ 37.8	$ 92.0

(1) As at April 1, 2005, following the changes in its internal organizational structure related to the operating segments of the Company, goodwill has been reassigned to the reporting segment using a related fair value allocation approach.

NOTE 11 – OTHER ASSETS

(amounts in millions)		**2007**		2006
Restricted cash	**$**	**2.8**	$	1.5
Investment in and advances to CVS Leasing Ltd. (i)		**43.5**		39.0
Deferred development costs, net of accumulated amortization of $27.4 (2006 – $22.6) (ii)		**24.7**		26.1
Deferred pre-operating costs, net of accumulated amortization of $21.6 (2006 – $18.6) (iii)		**13.1**		9.2
Deferred financing costs, net of accumulated amortization of $15.3 (2006 – $14.5)		**7.5**		7.4
Long-term receivables (iv)		**3.9**		11.7
Accrued benefit asset (Note 23)		**24.1**		20.8
Other, net of accumulated amortization of $5.7 million (2006 – $3.6 million)		**9.9**		20.5
	$	**129.5**	$	136.2

(i) The Company leads a consortium, which was contracted by the United Kingdom (U.K.) Ministry of Defense (MoD) to design, construct, manage, finance and operate an integrated simulator-based aircrew training facility for the Medium Support Helicopter (MSH) 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, built the facility and operates the training centre. Aircrew has been consolidated with the accounts of the Company since its inception.

In addition, the Company has a 14% minority shareholding and has advanced funds to CVS Leasing Ltd. (CVS), the entity that owns the simulators and other equipment leased to Aircrew. In March 2005, CVS refinanced its operations through an amount of £70.6 million of financing, which expires in October 2016.

(ii) R&D expenditures aggregated to $95.0 million during the year (2006 – $91.3 million; 2005 – $93.5 million), of which $3.0 million represents development costs that qualify for a deferral pursuant to CICA requirements (2006 – $1.8 million; 2005 – $9.9 million).

The Company has recorded government contribution against these amounts (refer to Note 22).

The total of deferred development costs amortized during the year amounted to $4.8 million (2006 – $13.1 million, 2005 – $3.9 million).

(iii) The Company defers costs incurred during the pre-operating period for all new operations. Capitalization ceases and amortization begins when operations commence. In fiscal 2007, $5.9 million was capitalized (2006 – $0.7 million) and an amortization of $3.0 million was taken (2006 – $4.0 million; 2005 – $6.1 million).

(iv) During fiscal 2007, the Company received early payment, in full, of $9.3 million for the secured subordinated promissory long- term notes. For fiscal 2006, long-term receivables included secured subordinated promissory notes in connection with the sale of its various Cleaning Technologies businesses totalling $8.5 million. The notes bore interest at rates ranging from 3% to 7%.

NOTE 12 – DEBT FACILITIES

A. LONG-TERM DEBT

(amounts in millions)		**2007**	2006
Recourse debt			
(i) Senior notes	**$**	**107.2**	$ 126.1
(ii) Revolving unsecured term credit facilities, 5 years maturing July 2010; US$400.0 (outstanding as at March 31, 2007 – USNil, as at March 31, 2006 – USNil)		**–**	–
5 years maturing July 2010, E100.0 (outstanding as at March 31, 2007 – Nil, as at March 31, 2006 – Nil)		**–**	–
(iii) Term loans, maturing in May and June 2011 (outstanding as at March 31, 2007 – E22.8 and E4.5, as at March 31, 2006 – E26.9 and E5.3)		**42.1**	45.6
(iv) Grapevine Industrial Development Corporation bonds, secured, maturing in January 2010 and 2013 (US$27.0)		**31.1**	31.5
(v) Miami Dade County Bonds, maturing in March 2024 (US$11.0)		**12.7**	12.8
(vi) Other debt, maturing in December 2012		**9.5**	4.9
(vii) Obligations under capital lease commitments		**11.1**	13.5
Non-recourse debt (1)			
(viii) Term loan of £12.7 secured, maturing in October 2016 (outstanding as at March 31, 2007 – £4.5, as at March 31, 2006 – £5.3)		**10.3**	10.7
(ix) Term loan maturing in June 2021 (outstanding as at March 31, 2007 – E25.2, as at March 31, 2006 – E13.9)		**38.8**	19.7
(x) Term loans maturing in December 2009 (outstanding as at March 31, 2007 – US$17.7, as at March 31, 2006 – US$5.6)		**20.4**	6.5
	$	**283.2**	$ 271.3
Less:			
Current portion of long-term debt		**25.3**	8.0
Current portion of capital lease		**1.9**	2.4
	$	**256.0**	$ 260.9

(1) Non-recourse debt to CAE, as a parent company, is classified as such when recourse against the debt in a subsidiary is limited to the assets, equity interest and undertaking of such subsidiary.

(i) Pursuant to a private placement, the Company borrowed US$108 million. During the last quarter of fiscal 2007, CAE prepaid the US$15.0 million dollar tranche, which matured in June 2007. These unsecured senior notes rank equally with term bank financings with fixed repayment amounts of 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%. The Company has entered into an interest rate swap agreement converting the fixed interest rate into the equivalent of a three-month LIBOR borrowing rate plus 3.6% on US$33.0 million of the senior notes.

(ii) On July 7, 2005, the Company entered into a revolving credit agreement. This revolving unsecured term credit facility (US$400.0 million and E100.0 million) has a committed term of five years maturing in July 2010. The facility has covenants covering minimum shareholders' equity, interest coverage and debt coverage ratios. The applicable interest rate on this revolving term credit facility is at the option of the Company, based on the bank's prime rate, bankers' acceptances or LIBOR plus a spread which, depends on the credit rating assigned by Standard & Poor's Rating Services.

(iii) The Company, in association with Iberia Lineas de España, combined their aviation training operations in Spain. The operators financed the acquisition of the simulators from CAE and Iberia through asset-backed financing maturing in May and June 2011. As part of the lease agreements, should the October 2003 agreement be terminated, CAE and Iberia will be obliged to repurchase the simulators they contributed, in proportion to the fair value of the simulators, for a total amount equal to the outstanding balance under the financing agreement. Quarterly capital repayments are made for the term of the financing. The implicit interest rate is 4.60%. The net book value of the simulators being financed, as at March 31, 2007, is equal to approximately $79.7 million (E51.7 million) – (2006 – $76.8 million [E54.2 million]) .

(iv) 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 mature in 2010 and 2013, respectively. Real property, improvements, fixtures and specified simulation equipment secure the bonds. The rates are set periodically by the remarketing agent based on market conditions. The rate for bonds maturing in 2010 is set on a weekly basis. The rate for bonds maturing in 2013 is set on an annual basis and is subject to a maximum rate of 10% permissible under current applicable laws. As at March 31, 2007, the combined rate for both series was approximately 4.77% (2006 – 3.92%). 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, 2007. Also, a letter of credit has been issued to support the bonds for the outstanding amount of the loans.

(v) The Miami Dade County Bonds, maturing in March 2024 (US$11.0 million), are secured by a simulator. As at March 31, 2007, the applicable floating rate, which is reset weekly, was 4.78%. Also, a letter of credit has been issued to support the bonds for the outstanding amount of the loans.

(vi) An unsecured $35.0 million facility to secure financing for the cost of the establishment of enterprise resource planning (ERP) system. A drawdown under the facility can be made only once the costs are incurred, on a quarterly basis, with monthly repayments over a term of seven years beginning at the end of the first month following each quarterly disbursement. The average interest rate on the borrowings is approximately 6.1%.

(vii) These capital leases are related to the leasing of various equipment and simulators. The effective interest rate on obligations under capital leases, which have staggered maturities until June 2010 was approximately 6.18% as at March 31, 2007 (2006 – 5.92%).

(viii) The Company arranged project financing, which was refinanced during December 2004 for one of its subsidiaries to finance its MSH program for the MoD in the U.K. 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 2016. The financing is non-recourse to CAE. Interest on the loans is charged at a rate approximating LIBOR plus 0.85%. The Company has entered into an interest rate swap totalling £4.2 million, fixing the interest rate at 6.31%. The book value of the assets pledged as collateral for the credit facility as at March 31, 2007, is £27.4 million (2006 – £26.9 million).

(ix) Term loan, maturing in June 2021, representing CAE's proportionate share (25%) of the German NH90 project. The total amount available for the project Company under the facility is E175.5 million. The debt is non-recourse to CAE. The borrowings bear interest at a EURIBOR rate and are currently swapped to fixed rate of 3.8%.

(x) The other debt is the result of CAE's proportionate share (49%) of term debt for the acquisition of simulators on a non-recourse basis, for its joint venture in the Zhuhai Training Center. The term debt has been arranged through several financial institutions.

Borrowings bear interest on a floating rate basis of U.S. Libor plus a spread ranging from 0.3% to 1%, and have maturities between March 2008 and December 2009. In accordance with the debt agreements, the joint venture may draw up to an additional US$6.4 million (CAE's proportionate 49% share: US$3.1 million) during FY2008 to fund payments for simulators.

Payments required in each of the next five fiscal years to meet the retirement provisions of the long-term debt and capital leases are as follows:

(amounts in millions)	Long-term debt	Capital lease	Total
2008	$ 25.3	$ 1.9	$ 27.2
2009	14.2	0.8	15.0
2010	94.6	0.8	95.4
2011	16.0	7.6	23.6
2012	9.8	–	9.8
Thereafter	112.2	–	112.2
	$ 272.1	**$ 11.1**	**$ 283.2**

As at March 31, 2007, CAE is in full compliance with its financial covenants.

B. SHORT-TERM DEBT

The Company has an unsecured and uncommitted bank line of credit available in Euros totalling $4.6 million (2006 – $41.2 million; 2005 – $31.0 million), of which none is used as at March 31, 2007 (2006 – Nil; 2005 – $11.2 million). The line of credit bears interest at a Euro base rate.

NOTE 12 – DEBT FACILITIES (CONT'D)

C. NTEREST EXPENSE, NET

Details of interest expense (income) are as follows:

(amounts in millions)	**2007**	2006	2005
Long-term debt interest expense	**$ 18.5**	$ 21.6	$ 35.3

Amortization of deferred financing costs and other	**2.3**	4.0	9.7
Allocation of interest expense to discontinued operations	**–**	–	(1.4)
Interest capitalized	**(4.1)**	(2.8)	(5.8)
Interest on long-term debt	**16.7**	22.8	37.8
Interest income	**(4.8)**	(6.9)	(5.7)
Other interest expense (income), net	**(1.3)**	0.3	–
Interest income, net	**(6.1)**	(6.6)	(5.7)
Interest expense, net	**$ 10.6**	$ 16.2	$ 32.1

The Company's year-to-date interest income is a result of interest revenue due to the accretion of discounts on the long-term notes receivable settled, in full, during the second quarter of fiscal 2007, to interest revenue on cash on hand and to advances to CVS Leasing Ltd. (CVS). CVS is an entity that owns simulators and other equipment used to train U.K. Ministry of Defense pilots at

the Company's Benson Air Force Base Training Centre. The Company owns a minority shareholding of 14% in CVS.

NOTE 13 – DEFERRED GAINS AND OTHER LONG-TERM LIABILITIES

(amounts in millions)	**2007**	2006
		Restated (Note 1)
Deferred gains on sale and leasebacks (i)	**$ 84.0**	$ 87.5
Deferred revenue	**20.3**	31.3
Deferred gains	**15.0**	6.6
Employee benefits obligation (Note 23)	**26.9**	23.9
Government cost-sharing (Note 22)	**14.5**	12.2
Non-controlling interest (ii)	**18.2**	17.6
Long-term portion of purchase agreement (iii)	**7.9**	8.1
Long-term payable to Investissement Québec	**1.4**	2.1
LTI RSU/DSU compensation obligation	**35.3**	14.5
Other	**9.2**	7.4
	$ 232.7	$ 211.2

(i) The related amortization for the year amounts to $4.0 million (2006 – $3.9 million; 2005 – $3.5 million).

(ii) Non-controlling interest of 20% of the civil training centres in Madrid combined with 22% in Military CAE Aircrew Training Centre.

(iii) Long-term portion of purchase agreement for data and parts delivered to CAE Inc. by Dassault Aviation on specific sales orders. The annual payments will be E2.6 in April 2008 and E2.6 million in April 2009.

NOTE 14 – INCOME TAXES

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

(amounts in millions)	**2007**	2006	2005
		Restated (Note 1)	Restated (Note 1)
Earnings (loss) before income taxes and discontinued operations	**$ 178.8**	$ 87.8	$ (405.0)
Canadian statutory income tax rates	**32.08%**	31.41%	31.27%
Income taxes at Canadian statutory rates	**$ 57.4**	$ 27.6	$ (126.6)
Difference between Canadian statutory rates and those applicable to foreign subsidiaries	**(2.8)**	0.3	(12.2)
Goodwill impairment	**–**	–	61.7
Losses not tax effected	**0.3**	2.8	2.7

Tax benefit of operating losses not previously recognized	**(2.3)**	(9.1)	(12.2)
Tax benefit of capital losses not previously recognized	**–**	(0.8)	(11.3)
Non-taxable capital gain	**(0.6)**	(0.3)	(0.1)
Non-deductible items	**2.4**	1.4	4.2
Prior years' tax adjustments and assessments	**(1.0)**	(0.9)	(3.6)
Impact of change in income tax rates on future income taxes	**(1.2)**	1.9	(1.0)
Non-taxable research and development tax credits	**(0.8)**	(0.9)	(1.5)
Large corporation tax	**–**	0.7	–
Other tax benefit not previously recognized	**(3.2)**	(2.9)	–
Exchange translation items	**–**	(0.7)	–
Other	**1.5**	(0.9)	(0.7)
Total income tax expense (recovery)	**$ 49.7**	$ 18.2	$ (100.6)

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

(amounts in millions)	**2007**	2006	2005
Current income tax expense	**$ 63.9**	$ 13.1	$ 13.5
Future income tax expense (recovery)			
Tax benefit of operating losses not previously recognized	**(2.3)**	(9.1)	(12.2)
Tax benefit of capital losses not previously recognized	**–**	(0.8)	(11.3)
Impact of change in income tax rates on future income taxes	**(1.2)**	1.9	(1.0)
Other tax benefit not previously recognized	**(3.2)**	(2.9)	–
Fixed asset impairment	**–**	–	(72.6)
Change related to temporary differences	**(7.5)**	16.0	(17.0)
Total income tax expense (recovery)	**$ 49.7**	$ 18.2	$ (100.6)

NOTE 14 – INCOME TAXES (CONT'D)

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

(amounts in millions)	**2007**	2006
		Restated (Note 1)
Future income tax assets		
Non-capital loss carryforwards	**$ 39.7**	$ 55.7
Capital loss carryforwards	**6.5**	6.5
Intangible assets	**27.1**	31.5
Amounts not currently deductible	**23.4**	20.2
Deferred revenues	**17.3**	13.5
Tax benefit carryover	**10.4**	10.1
Deferred research & development expenses	**–**	7.0
Other	**1.4**	2.5
	125.8	147.0
Valuation allowance	**(25.3)**	(37.5)
	$ 100.5	$ 109.5
Future income tax liabilities		
Investment tax credits	**$ (22.5)**	$ (22.6)
Property, plant and equipment	**(9.7)**	(28.5)
Percentage-of-completion versus completed contract	**(2.3)**	(15.8)
Deferred research & development expenses	**(2.5)**	–
	(37.0)	(66.9)
Net future income tax assets	**$ 63.5**	$ 42.6

Net current future income tax asset	**$**	**3.7**	$	5.7
Net non-current future income tax asset		**81.5**		78.2
Net current future income tax liability		**(4.9)**		(14.5)
Net non-current future income tax liability		**(16.8)**		(26.8)
	$	**63.5**	$	42.6

As at March 31, 2007, the Company has accumulated non-capital losses carried forward relating to operations in Canada for approximately $2.8 million. For financial reporting purposes, a net future income tax asset of $0.8 million has been recognized in respect of these loss carry forwards.

As at March 31, 2007, the Company has accumulated non-capital losses carried forward relating to operations in the United States for approximately $48.4 million (US$42.0 million). For financial reporting purposes, a net future income tax asset of $16.9 million (US$14.6 million) has been recognized in respect of these loss carry forwards.

The Company has accumulated non-capital tax losses carried forward relating to its operations in other countries of approximately $83.6 million. For financial reporting purposes, a net future income tax asset of $15.4 million has been recognized.

The Company also has accumulated capital losses carried forward relating to operations in Canada for approximately $5.3 million. For financial reporting purposes, a net future income tax asset of $0.6 million has been recognized.

The Company also has accumulated capital losses carried forward relating to operations in the United States for approximately $15.4 million (US$13.3 million). For financial reporting purposes, no future income tax asset was recognized, as a full valuation allowance was taken.

The non-capital losses for income tax purposes expire as follows:

(amounts in millions)	United States (US$)	Other countries (CA$)
Expiry date:		
2008	$ –	$ –
2009	4.3	–
2010	–	–
2011	10.7	–
2012	18.1	–
2013 – 2024	7.8	10.9
No expiry date	–	75.5
	$ 40.9	$ 86.4

The valuation allowance principally relates 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 2007, $5.5 million (2006 – $16.7 million) of the valuation allowance balance was reversed based on the assessment of the Company that it is more likely than not that the future income tax benefits will be realized.

NOTE 15 – CAPITAL STOCK AND CONTRIBUTED SURPLUS

CAPITAL STOCK

Authorized

The Company is authorized to issue an unlimited number of common shares without par value and an unlimited number of preferred shares without par value, issuable in series.

The preferred shares may be issued with rights and conditions to be determined by the Board of Directors, prior to their issue. To date, the Company has not issued any preferred shares.

Issued

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

	2007		2006		2005
(amounts in millions,	**Number**	**stated**	Number	stated	Number	stated

except number of shares)	**of shares**	**value**	of shares	value	of shares	value
Balance at beginning of year	**250,702,430**	**$ 389.0**	248,070,329	$ 373.8	246,649,180	$ 367.5
Shares issued (Note 2)[(a)] (b)	**–**	**–**	1,091,564	6.9	424,628	2.0
Stock options exercised	**1,236,895**	**10.0**	1,497,540	8.0	869,620	3.6
Transfer of contributed surplus upon exercise of stock options	**–**	**2.5**	–	–	–	–
Stock dividends	**21,124**	**0.2**	42,997	0.3	126,901	0.7
Balance at end of year	**251,960,449**	**$ 401.7**	250,702,430	$ 389.0	248,070,329	$ 373.8

(a) On May 20, 2005, the Company issued 1,000,000 common shares at a price of $6.13 per share for the acquisition of Terrain Experts Inc. On November 30, 2005, the Company issued 91,564 common shares at a price of $8.07 per share for the second tranche payment of CAE Professional Services (Canada) Inc. (formerly Greenley & Associates Inc. [G&A]).

(b) On November 30, 2004, the Company issued 424,628 common shares at a price of $4.71 per share for the first tranche payment of CAE Professional Services (Canada) Inc.

NOTE 15 – CAPITAL STOCK AND CONTRIBUTED SURPLUS (CONT'D)

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

	2007	2006	2005
Weighted average number of common shares outstanding – Basic	**251,110,476**	249,806,204	247,060,580
Effect of dilutive stock options	**1,894,730**	2,325,422	812,273
Weighted average number of common shares outstanding – Diluted	**253,005,206**	252,131,626	247,872,853(1)

(1) For fiscal 2005, the effect of stock options potentially exercisable on pro forma net loss per share was anti-dilutive; therefore, basic and diluted pro forma net loss per share are the same.

Options to acquire 1,397,200 common shares (2006 – 2,269,150; 2005 – 4,635,100) have been excluded from the above calculation since their inclusion would have an anti-dilutive effect.

CONTRIBUTED SURPLUS

A reconciliation of contributed surplus is as follows:

(amounts in millions)	**2007**	2006	2005
		Restated (Note 1)	Restated (Note 1)
Balance at beginning of year	**$ 5.6**	$ 3.5	$ 2.1
Transfer to common stock upon exercise of stock options	**(2.5)**	–	–
Stock-based compensation (Note 17)	**2.6**	2.1	1.4
Balance at end of year	**$ 5.7**	$ 5.6	$ 3.5

NOTE 16 – CUMULATIVE TRANSLATION ADJUSTMENT

The net change in the currency translation adjustment account is as follows:

(amounts in millions)	**2007**	2006
Balance at beginning of year	**$ (115.2)**	$ (66.3)
Effect of changes in exchange rates during the year:		
On net investment in self-sustaining subsidiaries, net of tax recovery of $0.2 (2006 – tax recovery of $2.2)	**26.3**	(47.0)
On certain long-term debt denominated in foreign currencies designated as a hedge of net investments in self-sustaining foreign subsidiaries, net of tax expense of $0.3 (2006 – tax expense of $0.9)	**1.2**	3.7
Portion included in income as a result of reductions in net		

investments in self-sustaining foreign operations, net of taxes of nil (2006 – tax expense of $0.3)	–	(5.6)
Balance at end of year	**$ (87.7)**	$ (115.2)

NOTE 17 – STOCK-BASED COMPENSATION PLANS

EMPLOYEE STOCK OPTION PLAN

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

As at March 31, 2007, a total of 9,484,076 common shares remained authorized for issuance under the Employee Stock Option Plan (ESOP). 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 outstanding become immediately exercisable by option holders. 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:

Years ended March 31	**2007**		2006		2005	
	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	**6,347,235**	**$ 7.66**	8,208,675	$ 7.52	8,128,370	$ 7.51
Granted	**647,700**	**$ 9.13**	568,200	$ 5.96	2,046,650	$ 5.68
Exercised	**(1,236,895)**	**$ 8.07**	(1,497,540)	$ 5.29	(869,620)	$ 4.15
Forfeited	**(316,125)**	**$ 10.60**	(932,100)	$ 9.21	(809,725)	$ 6.77
Expired	**–**	**$ –**	–	$ –	(287,000)	$ 6.43
Options outstanding at end of year	**5,441,915**	**$ 7.57**	6,347,235	$ 7.66	8,208,675	$ 7.52
Options exercisable at end of year	**2,986,135**	**$ 8.58**	2,775,850	$ 9.90	3,731,085	$ 8.76

The following table summarizes information about the Company's ESOP as at March 31, 2007:

	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 $6.03	**2,879,215**	**2.98**	**$ 5.02**	**1,584,235**	**$ 5.03**
$6.19 to $9.20	**1,165,500**	**4.30**	**$ 7.82**	**11,400**	**$ 8.08**
$10.31 to $14.60	**1,397,200**	**0.92**	**$ 12.62**	**1,390,500**	**$ 12.63**
Total	**5,441,915**	**2.73**	**$ 7.57**	**2,986,135**	**$ 8.58**

For the year ended March 31, 2007, compensation cost for CAE's stock options was recognized in consolidated net earnings (loss) with a corresponding credit of $2.6 million (fiscal 2006 – $2.1 million, fiscal 2005 – $1.4 million) to contributed surplus using the fair value method of accounting for awards that were granted since 2004. Due to the application of EIC-162, which requires retroactive restatement of prior periods, the compensation cost for CAE stock options have been restated (refer to Note 1).

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

	2007	2006	2005
Assumptions used in the Black-Scholes options pricing model:			
Dividend yield	**0.44%**	0.67%	1.26%
Expected volatility	**45.0%**	47.0%	40.0%
Risk-free interest rate	**4.38%**	4.0%	5.75%
Expected option term	**4**	6	6
Weighted average fair value of options granted	**$ 3.57**	$ 2.84	$ 2.27

NOTE 17 – STOCK-BASED COMPENSATION PLANS (CONT'D)

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 (loss) and pro forma basic and diluted net earnings (loss) per share are presented below:

(amounts in millions, except per share amounts)	2007	2006	2005
		Restated (Note 1)	Restated (Note 1)
Net earnings (loss), as reported	**$ 127.4**	$ 63.6	$ (199.6)
Pro forma impact	**(0.1)**	(0.7)	(1.9)
Pro forma net earnings (loss)	**$ 127.3**	$ 62.9	$ (201.5)
Pro forma basic net earnings (loss) per share	**$ 0.51**	$ 0.25	$ (0.82)
Pro forma diluted net earnings (loss) per share (1)	**$ 0.50**	$ 0.25	$ (0.82)

(1) For fiscal 2005, the effect of stock options potentially exercisable on pro forma net loss per share was anti-dilutive; therefore, the basic and diluted pro forma net loss per share are the same.

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 18% of their annual base salary. The Company and its participating subsidiaries match the first $500 employee contribution and contribute $1 for every $2 on additional employee contributions, up to a maximum of 3% of the employee's base salary. Employees may contribute to the plan through payroll deductions or a lump-sum contribution. The employee and employer contribution may be invested in the employee Register Retirement Saving Plan (RRSP) or Deferred Profit Sharing Plan (DPSP). 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 TSX. The Company recorded compensation expense in the amount of $3.1 millio n (2006 – $2.1 million; 2005 – $1.4 million) in respect of employer contributions under the Plan.

DEFERRED SHARE UNIT PLAN

The Company maintains 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 5,000 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 5,000 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 units are issued on the basis of the closing board lot sale price per share of CAE common shares on the Toronto Stock Exchange during the last day on which the common share traded prior to the date of issue.

The Company records the cost of the DSU Plan as compensation expense. As at March 31, 2007, 425,092 units were outstanding at a value of $5.4 million (2006 – 388,972 units at a value of $3.6 million; 2005 – 343,116 units at a value of $1.9 million). A total numberof 24,176 units were

redeemed during the fiscal year endedMarch 31, 2007 under both DSU Plans in accordance with their respective plan text, for a total of $0.2 million. For the year ended March 31, 2007, March 31, 2006 and March 31, 2005 no DSUs were cancelled.

LONG-TERM INCENTIVE (LTI) – DEFERRED SHARE UNIT PLAN

Both Long-Term Incentive Deferred Share Unit Plans (LTI-DSU) are intended to enhance the Company's ability to promote a greater alignment of interests between executives and shareholders of the Company. LTI-DSUs are granted to executives and managers of the Company. A LTI-DSU is equal in value to one common share net of withholding tax at a specific date. The LTI-DSU also accrued dividend equivalents payable in additional units in an amount equal to dividends paid on CAE common shares.

April 2003 Plan

The April 2003 LTI-DSU Plan stipulates that granted units vest equally over four years and can be redeemed for cash. Upon termination of employment for reasons of long-term disability, involuntary termination, retirement or death, eligible participants with vested LTI-DSU units will be entitled to receive the fair market value of the equivalent number of CAE common shares. As at March 31, 2007, 548,097 LTI-DSU units were outstanding (March 31, 2006 – 657,036 units). The expense recorded in fiscal 2007 was $0.2 million (2006 – $1.6 million; 2005 – $0.8 million). Due to the application of EIC-162, which requires retroactive restatement of prior periods, the expense amounts have been restated.

May 2004 Plan

The May 2004 LTI-DSU Plan has replaced the April 2003 LTI-DSU Plan for succeeding years. The May 2004 LTI-DSU Plan stipulates that granted units vest equally over five years and can be redeemed for cash. Upon termination of employment, eligible participants with vested DSU units will be entitled to receive the fair market value of the equivalent number of CAE common shares. In fiscal 2007, the Company issued 527,714 LTI-DSU units (2006 – 430,503 units) and as at March 31, 2007, 1,392,653 LTI-DSU units were outstanding (2006 – 916,722 units outstanding). The expense recorded in fiscal 2007 was $7.5 million (2006 – $2.8 million; 2005 – $0.8 million). Due to the application of EIC-162, which requires retroactive restatement of prior periods, the expense amounts have been restated.

Since fiscal 2004, the Company entered into contracts to reduce its earnings exposure to the fluctuations in its share price (refer to Note 18).

LONG-TERM INCENTIVE – RESTRICTED SHARE UNIT PLAN

In May 2004, the Company adopted a Long-Term Incentive Performance Based Restricted Shares Unit Plan (LTI-RSU) for its executives and managers. The LTI-RSU plan is intended to enhance the Company's ability to attract and retain talented individuals, and also to promote a greater alignment of interest between eligible participants and the Company's shareholders. The LTI-RSU Plan is set up as a stock-based performance plan.

LTI-RSUs granted pursuant to this Plan vest after three years from their grant date. LTI-RSUs are vested as follows:

(i) 100% of the units, if CAE shares have appreciated at least 33% (10% annual compounded growth) during the timeframe.

(ii) 50% of the units, if CAE shares have appreciated at least 24% (7.5% annual compounded growth) but less than 33% during the timeframe.

No LTI-RSUs vest if the market value of the common shares has appreciated less than 24% during the specified timeframe. In addition, no proportional vesting is to occur for any appreciation resulting between 24% and 33% during the specified timeframe. Participants subject to loss of employment, other than voluntarily or for cause, are entitled to conditional pro-rata vesting. In fiscal 2007, the Company issued 770,948 LTI-RSU units (2006 – 637,561 units) and as at March 31, 2007, 2,009,666 LTI-RSU units were outstanding (2006 – 1,224,918 units outstanding). The expense recorded in fiscal 2007 was $12.1 million (2006 – $3.5 million; 2005 – $0.4 million). Due to the application of EIC-162, which requires retroactive restatement of prior periods, the expense amounts have been restated.

NOTE 18 – FINANCIAL INSTRUMENTS

FOREIGN CURRENCY RISK

The Company entered into forward foreign exchange contracts totalling $604.1 million (buy contracts $91.4 million and sell contracts totalling $512.7 million). The total net unrealized loss as of March 31, 2007, is $7.6 million (unrealized gain on buy contracts of $0.8 million and unrealized loss on sell contracts of $8.4 million).

NOTE 18 – FINANCIAL INSTRUMENTS (CONT'D)

Consolidated foreign exchange transactions outstanding

(amounts in millions, except average rate)	**2007**		2006	
Currencies (Sold/Bought)	**Notional amount (1)**	**Average rate**	Notional amount(1)	Average rate

USD/CDN					
Less than 1 year	**$**	**223.3**	**0.8697**	$ 184.6	0.8448
Between 1 and 3 years		**54.3**	**0.8908**	71.2	0.8600
Between 3 to 5 years		**15.7**	**0.9007**	2.9	0.8783
USD/EUR					
Less than 1 year		**11.0**	**1.2964**	5.7	1.2590
Between 1 and 3 years		**4.0**	**1.2957**	9.1	1.2852
CDN/EUR					
Less than 1 year		**12.9**	**1.5360**	2.1	1.4003
Between 1 and 3 years		**5.4**	**1.4666**	–	–
Between 3 and 5 years		**1.5**	**1.4642**	–	–
EUR/CDN					
Less than 1 year		**94.9**	**0.6649**	10.5	0.6758
Between 1 and 3 years		**29.4**	**0.6712**	13.3	0.6387
Between 3 and 5 years		**1.5**	**0.6934**	3.5	0.6118
EUR/AUD					
Less than 1 year		**1.0**	**0.5800**	–	–
Between 1 and 3 years		**1.6**	**0.5586**	–	–
GBP/CDN					
Less than 1 year		**4.1**	**0.4796**	1.9	0.4476
Between 1 and 3 years		**47.5**	**0.4964**		
CDN/GBP					
Less than 1 year		**0.5**	**2.2783**	–	–
GBP/EUR					
Less than 1 year		**19.4**	**0.6821**	–	–
GBP/USD					
Less than 1 year		**20.0**	**0.5181**	–	–
CDN/USD					
Less than 1 year		**52.3**	**1.1564**	17.5	1.1616
Between 1 and 3 years		**3.8**	**1.0986**	–	–
	$	**604.1**		$ 322.3	

(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 monitoring of the risk. In addition, the Company typically receives substantial non-refundable deposits on contracts. The Company closely monitors its exposure to major airlines in order to mitigate its risk to the extent possible.

The Company is exposed to credit risk in the event of non-performance by counterparties to its derivative financial instruments. The Company minimizes this exposure by entering into contracts with counterparties that are of high credit quality. Collateral or other security to support financial instruments subject to credit risk is usually not obtained. The credit standing of counterparties is regularly monitored. As well, the Company's credit exposure is further reduced by the sale of third-party receivables (see Note 6 *Accounts Receivable*) to a financial institution on a non-recourse basis.

INTEREST RATE EXPOSURE

The Company bears some interest rate fluctuation risk on its variable long-term debt (including rates) and some fair value risk on its fixed interest long-term debt. As at March 31, 2007, the Company has entered into three interest rate swap agreements with three different financial institutions to mitigate these risks for a total notional value of $86.2 million. One agreement, with a notional value of $38.1 million (US$33.0 million), has converted fixed interest rate debt into a floating rate whereby the Company pays the equivalent of a three-month LIBOR borrowing rate, plus 3.6%, and receives a fixed interest rate of 7.76% up to June 2012. The remaining contracts convert a floating interest rate debt into a fixed rate for a notional value of $48.1 million, whereby the Company will receive quarterly LIBOR and pay fixed interest payments as follows:

- Amortizing based on a repayment schedule of the debt until October 2016 on $9.6 million (£4.2 million), the Company will pay quarterly fixed annual interest rates of 6.31%
- Accreting swap based on a borrowing schedule until December 2019 on $38.5 million (e25.0 million), the Company will pay a semi-annual fixed annual interest rate of 3.78%

After considering these swap agreements, as at March 31, 2007, 60% of the long-term debt bears fixed interest rates.

STOCK-BASED COMPENSATION COST

In March 2004, June 2006 and March 2007 the Company entered into three equity swap agreements with three major Canadian financial institutions to reduce its cash and earnings exposure to fluctuations in its share price relating to the DSU and LTI-DSU programs. Pursuant to the agreement, the Company receives the economic benefit of dividends and a 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 partly offsets movements in the Company's share price impacting the cost of the DSU and LTI-DSU programs and is reset monthly. As at March 31, 2007, the equity swap agreement covered 1,495,000 common 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 cash equivalents, accounts receivable, accounts payable and accrued liabilities are valued at their carrying amounts on the Consolidated Balance Sheets, which represent an appropriate estimate of their fair values due to their short-term maturities.
- Capital leases are valued using the discounted cash flow method.
- The value of long-term debt 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 Consolidated Balance Sheet date.
- Forward foreign exchange contracts are represented by the estimated amounts that the Company would receive or pay to settle the contracts at the Consolidated Balance Sheet date.

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

(amounts in millions)	**2007**		2006	
	Fair value	**Carrying amount**	Fair value	Carrying amount
Long-term debt	**$ 288.5**	**$ 283.2**	$ 277.9	$ 271.3
Net forward foreign exchange contracts	**(7.6)**	**–**	5.4	–
Interest rate swap contracts	**1.0**	**–**	(1.5)	–

LETTERS OF CREDIT AND GUARANTEES

As at March 31, 2007, the Company had outstanding letters of credit and performance guarantees in the amount of $149.1 million (2006 – $98.6 million) issued in the normal course of business. These guarantees are issued under mainly the Revolving Term Credit Facility as well as the Performance Securities Guarantee (PSG) account provided by Export Development Corporation (EDC) and under other 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 letter of credit for the operating lease obligation provides credit support for the benefit of the owner participant in the September 30, 2003 sale and leaseback transaction and varies according to the payment schedule of the lease agreement.

NOTE 18 – FINANCIAL INSTRUMENTS (CONT'D)

(amounts in millions)	**2007**	2006
Advance payment	**$ 68.7**	$ 34.0
Contract performance	**6.7**	13.0
Operating lease obligation	**27.2**	27.3
Simulator deployment obligation	**40.7**	19.6
Other	**5.8**	4.7
Total	**$ 149.1**	$ 98.6

Of the $68.7 million of advance payment guarantees, $65.6 million are issued under the EDC PSG account.

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 $52.1 million (2006 – $52.4 million), of which $12.3 million matures in 2008, $22.4 million in 2009, $8.2 million in 2020 and $9.2 million in 2023. Of this amount, as at March 31, 2007, $33.1 million is recorded as a deferred gain (2006 – $33.1 million).

N DEMNIFICATIONS

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 that exist, or arise 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 other than the liabilities already accrued, t he maximum potential future payments that it 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 defenses, which cannot be estimated. However, costs incurred to settle claims related to these indemnifications have not been material to the Company's consolidated financial position, results of operations or cash flows.

NOTE 19 – SUPPLEMENTARY CASH FLOWS INFORMATION

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

(amounts in millions)	**2007**	2006	2005
Accounts receivable	**$ (39.2)**	$ (31.9)	$ 19.3
Inventories	**(14.8)**	13.8	53.3
Prepaid expenses	**4.0**	(7.9)	0.5
Income taxes recoverable	**20.2**	(7.5)	28.5
Accounts payable and accrued liabilities	**22.5**	58.9	(43.7)
Deposits on contracts	**27.5**	53.7	26.3
Decrease in non-cash working capital	**$ 20.2**	$ 79.1	$ 84.2
Interest paid	**$ 17.1**	$ 21.9	$ 38.2
Income taxes (recovered) paid, net	**$ (1.4)**	$ 13.7	$ –
Supplemental statements of earnings disclosure:			
Foreign exchange gain	**$ 2.9**	$ 8.4	$ 5.2

PROCEEDS FROM DISPOSAL OF DISCONTINUED OPERATIONS

For fiscal 2007, the net cash outflows regarding the proceeds from disposal of discontinued operations as reported in the Consolidated Statements of Cash Flows, are composed of a cash payment to L-3 in the amount of $10.2 million for the net working capital adjustments of the Marine Controls segment, offset, in part, by a cash receipt of $6.4 million from the sale of the aggregate land and building, which was previously classified as being held for sale.

NOTE 20 – CONTINGENCIES

In 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 consolidated financial position.

NOTE 21 – COMMITMENTS

Significant contractual purchase obligations and future minimum lease payments under operating leases are as follows:

(amounts in millions)	SP/C	SP/M	TS/C	TS/M	Total
Years ending March 31,					
2008	$ 7.3	$ 12.2	$ 54.7	$ 26.0	$ 100.2
2009	2.9	6.3	51.5	23.4	84.1
2010	0.4	2.7	34.0	20.4	57.5
2011	0.2	1.9	35.5	20.2	57.8
2012	–	0.6	42.1	17.7	60.4
Thereafter	0.3	0.4	187.4	37.2	225.3

	$ 11.1	$ 24.1	$ 405.2	$ 144.9	$ 585.3

As at March 31, 2007, included in the total contractual purchase obligations and future minimum lease payments under operating lease is an amount of $136.0 million (March 31, 2006 – $140.7 million, March 31, 2005 – $187.0 million) designated as commitments to CVS Leasing Ltd., an entity in which the Company has a 14% minority shareholding.

Of the total $585.3 million disclosed as being commitments as at March 31, 2007, $37.0 million represent contractual purchase obligations.

NOTE 22 – GOVERNMENT COST-SHARING

The Company has signed agreements with various governments whereby the latter shares in the cost, based on expenditures incurred by the Company, of certain R&D programs for modelling and services, visual systems and advanced flight simulation technology for civil applications and networked simulation for military applications.

PROJECT PHOENIX

During fiscal 2006, the Company announced a plan to invest $630 million in Project Phoenix, an R&D program that will span the next six years. In the same year, the Government of Canada and the Company signed an agreement for a contribution of approximately 30% ($189 million) of the value of CAE's R&D program. The Government of Canada support will reduce by approximately 25% the amount of income tax credit otherwise available. This agreement is included in the Technology Partnerships Canada (TPC) program created by Industry Canada to invest strategically in research and development, to encourage private sector investment, and to increase technological capabilities in the Canadian industry. The contribution will be repayable, based on consolidated revenues, starting in fiscal 2012 and ending in fiscal 2030, or earlier, should a predetermined royalty level, which exceeds the amount of maximum contributions, be reached.

During fiscal 2007, the Company signed an agreement with the Government of Québec, which will participate in Project Phoenix. The Québec government's support will take the form of a $31.5 million contribution over six years, repayable by royalties. Investissement Québec handles the contribution. The contribution will be repayable, based on consolidated revenues, starting in fiscal 2012 and ending in fiscal 2030, or earlier should a predetermined royalty level, which exceeds the amount of maximum contributions, be reached. The government contribution recognized by the Company in fiscal 2007, related to this agreement signed with the Government, is based on costs incurred starting in June 2005.

NOTE 22 – GOVERNMENT COST-SHARING (CONT'D)

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

(amounts in millions)	**2007**	2006
Outstanding contribution receivable, beginning of year	**$ 10.0**	$ –
Contributions	**52.1**	17.3
Payments received	**(43.7)**	(7.3)
Outstanding contribution receivable, end of year	**$ 18.4**	$ 10.0

PREVIOUS PROGRAMS

The Company had also signed previous R&D agreements with the Government of Canada, in order to share in a portion of specific costs incurred by the Company on previous R&D programs. The initiative was intended to broaden the Company's technological capabilities in flight simulation systems, by developing components that will lower the cost and weight of flight simulators and technologies to reduce the cost of initial training. These programs are repayable in the form of royalties to March 2011 and March 2013, based on future sales for civil and military programs respectively.

AGGREGATE INFORMATION ABOUT PROGRAMS

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

(amounts in millions)	**2007**	2006	2005
Contributions credited to capitalized costs:			
Project Phoenix	**$ 7.1**	$ 3.8	$ –
Previous programs	**–**	–	0.9
Contributions credited to income:			
Project Phoenix	**45.0**	13.5	–
Previous programs	**–**	7.5	9.9

Total contributions:			
Project Phoenix	**$ 52.1**	$ 17.3	$ –
Previous programs	**–**	7.5	10.8
Royalty expenses:			
Project Phoenix	**–**	–	–
Previous programs	**$ 7.5**	$ 6.6	$ 5.9

The cumulative contributions recognized by the Company, since their respective inceptions, for all current government cost sharing programs still active as at March 31, 2007 amounts to $149.9 million. The cumulative sum of royalty expenses recognized by the Company, since their respective inceptions, for all current government cost sharing programs still active as at March 31, 2007 amounts to $23.2 million.

As at March 31, 2007, the Company's short-term and long-term liabilities, in relation to future repayments of the aggregate R&D programs, amounted to $7.5 million and $14.5 million respectively. As at March 31, 2006, the Company's liability, in relation to future repayments of the aggregate R&D programs, amounted to $18.9 million, of which, $6.7 million was paid during fiscal 2007.

NOTE 23 – EMPLOYEE FUTURE BENEFITS

The Company has two registered funded defined-benefit pension plans in Canada (one for employees and one for designated executives) that provide benefits based on length of service and final average earnings. The Company also maintains a pension plan for employees in the Netherlands and in the United Kingdom that provides benefits based on similar provisions.

In addition, the Company maintains a supplemental arrangement plan in Canada and two in Germany (CAE Elektronik GmbH plan and CAE Beyss GmbH plan [Beyss]) to provide defined benefits. These supplemental arrangements are the sole obligation of the Company, and there is no requirement to fund it. However, the Company is obligated to pay the benefits when they become due. Under the Canadian supplemental arrangement, once the designated employee retires from the Company, the Company is required to secure the obligation for that employee. As at March 31, 2007, the Company has issued letters of credit totalling $21.2 million (2006 – $20.0 million) to secure these obligations under the Canadian supplemental arrangement.

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

In fiscal 2007, the Company closed some of its training centres in Europe, resulting in a curtailment gain of $0.9 million.

The changes in pension obligations, in fair value of assets and the financial position of the funded pension plans are as follows:

(amounts in millions)	**2007**			2006		
	Canadian	**Foreign**	**Total**	Canadian	Foreign	Total
Change in pension obligations						
Pension obligation at beginning of year	**$ 175.4**	**$ 15.6**	**$ 191.0**	$ 158.7	$ 15.3	$ 174.0
Adjustment U.K. plan	**–**	**4.1**	**4.1**	–	–	–
Current service cost	**6.0**	**0.8**	**6.8**	4.2	0.5	4.7
Interest cost	**9.1**	**0.9**	**10.0**	9.5	0.6	10.1
Curtailment	**–**	**(0.9)**	**(0.9)**	–	–	–
Employee contributions	**2.2**	**0.3**	**2.5**	2.5	0.4	2.9
Pension benefits paid	**(11.6)**	**(0.2)**	**(11.8)**	(8.2)	(0.1)	(8.3)
Actuarial loss (gain)	**10.6**	**(0.6)**	**10.0**	8.7	0.3	9.0
Foreign exchange variation	**–**	**1.9**	**1.9**	–	(1.4)	(1.4)
Pension obligation at end of year	**191.7**	**21.9**	**213.6**	175.4	15.6	191.0
Change in fair value of plan assets						
Fair value of plan asset at beginning of year	**144.7**	**15.9**	**160.6**	128.2	14.8	143.0
Adjustment U.K. plan	**–**	**3.4**	**3.4**	–	–	–
Actual return on plan assets	**18.1**	**1.1**	**19.2**	11.9	1.4	13.3
Pension benefits paid	**(11.6)**	**(0.2)**	**(11.8)**	(8.2)	(0.1)	(8.3)
Plan expenses	**–**	**–**	**–**	(0.3)	–	(0.3)
Employee contributions	**2.2**	**0.3**	**2.5**	2.5	0.4	2.9
Employer contributions	**9.7**	**0.9**	**10.6**	10.6	0.9	11.5
Foreign exchange variation	**–**	**1.9**	**1.9**	–	(1.5)	(1.5)

Fair value of plan assets at end of year	**163.1**	**23.3**	**186.4**	144.7	15.9	160.6
Financial position – plan (deficit)/surplus	**(28.6)**	**1.4**	**(27.2)**	(30.7)	0.3	(30.4)
Unrecognized net actuarial loss	**46.5**	**(1.0)**	**45.5**	45.9	(0.4)	45.5
Unamortized past service cost	**5.1**	**–**	**5.1**	5.6	–	5.6
Amount recognized at end of year	**$ 23.0**	**$ 0.4**	**$ 23.4**	$ 20.8	$ (0.1)	$ 20.7
Amount recognized in						
Other assets (Note 11)	**$ 23.0**	**$ 1.1**	**$ 24.1**	$ 20.8	$ –	$ 20.8
Other long–term liabilities	**–**	**(0.7)**	**(0.7)**	–	(0.1)	(0.1)
	$ 23.0	**$ 0.4**	**$ 23.4**	$ 20.8	$ (0.1)	$ 20.7

Included in the above pension obligation and fair value of plan assets at end of year are the following amounts in respect of plans that are in deficit (the two Canadian funded plans and the United Kingdom plan).

(amounts in millions)	**2007**			2006		
	Canadian	**Foreign**	**Total**	Canadian	Foreign	Total
Pension obligation at end of year	**$ 191.7**	**$ 4.8**	**$ 196.5**	$ 175.4	$ –	$ 175.4
Fair value of plan assets at end of year	**$ 163.1**	**$ 4.1**	**$ 167.2**	$ 144.7	$ –	$ 144.7
Financial position – plan deficit	**$ (28.6)**	**$ (0.7)**	**$ (29.3)**	$ (30.7)	$ –	$ (30.7)

NOTE 23 – EMPLOYEE FUTURE BENEFITS (CONT'D)

Pension obligations related to the supplemental arrangements are as follows (excluding Beyss pension plan):

(amounts in millions)	**2007**			2006		
	Canadian	**Foreign**	**Total**	Canadian	Foreign	Total
Change in pension obligations						
Pension obligation at beginning of year	**$ 21.7**	**$ 5.9**	**$ 27.6**	$ 16.1	$ 6.4	$ 22.5
Current service cost	**1.3**	**0.2**	**1.5**	0.9	0.2	1.1
Interest cost	**1.1**	**0.2**	**1.3**	1.0	0.2	1.2
Pension benefits paid	**(1.2)**	**(0.3)**	**(1.5)**	(1.4)	(0.3)	(1.7)
Actuarial loss	**0.9**	**0.1**	**1.0**	5.1	–	5.1
Foreign exchange variation	**–**	**0.5**	**0.5**	–	(0.6)	(0.6)
Pension obligation at end of year	**23.8**	**6.6**	**30.4**	21.7	5.9	27.6
Financial position – plan deficit	**(23.8)**	**(6.6)**	**(30.4)**	(21.7)	(5.9)	(27.6)
Unrecognized net actuarial loss	**5.8**	**1.6**	**7.4**	5.2	1.5	6.7
Amount recognized in other						
long-term liabilities at end of year	**$ (18.0)**	**$ (5.0)**	**$ (23.0)**	$ (16.5)	$ (4.4)	$ (20.9)

The net pension cost for funded pension plans for the years ended March 31 included the following components:

(amounts in millions)	**2007**	2006	2005

Current service cost	**$ 6.8**	$ 4.7	$ 3.6
Plan expenses	**–**	0.3	0.3
Interest cost on pension obligations	**10.0**	10.1	9.0
Actual return on plan assets	**(19.2)**	(13.3)	(12.6)
Net actuarial loss on benefit obligation	**10.0**	9.0	15.4
Past service cost arising from plan amendments in the period	**–**	–	0.9
Pension cost before adjustments to recognize the long-term nature of plans	**7.6**	10.8	16.6
Adjustments to recognize long-term nature of plans:			
Difference between expected return and actual return on plan assets	**8.1**	4.2	4.8
Difference between actuarial loss recognized for the year and actual actuarial loss on benefit obligations for the year	**(7.4)**	(6.7)	(14.0)
Difference between amortization of past service cost for the year and actual plan amendments for the year	**0.5**	0.5	(0.4)
Total adjustment	**1.2**	(2.0)	(9.6)
Net pension cost	**8.8**	8.8	7.0
Curtailment	**(0.9)**	–	–
Curtailment/settlement of discontinued operations	**–**	–	1.3
Net pension cost including curtailment/settlement of discontinued operations	**$ 7.9**	$ 8.8	$ 8.3

The following components are combinations of the items presented above:

(amounts in millions)	**2007**	2006	2005
Expected return on plan assets	**$ (11.1)**	$ (9.1)	$ (7.8)
Amortization of net actuarial loss	**2.6**	2.3	1.4
Amortization of past service costs	**0.5**	0.5	0.5

With respect to the supplemental arrangements, the net pension cost is as follows:

(amounts in millions)	**2007**	2006	2005
Current service cost	**$ 1.5**	$ 1.1	$ 0.8
Interest cost on pension obligations	**1.3**	1.2	1.0
Net actuarial loss on benefit obligations	**1.0**	5.1	1.0
Pension cost before adjustments to recognize the long-term nature of plans	**3.8**	7.4	2.8
Adjustments to recognize the long-term nature of plans:			
Difference between actuarial loss recognized for the year and actual actuarial loss on benefit obligations for the year	**(0.6)**	(5.0)	(1.0)
Net pension cost	**3.2**	2.4	1.8
Curtailment/settlement of discontinued operations	**–**	–	(0.4)
Net pension cost including curtailment/settlement of discontinued operations	**$ 3.2**	$ 2.4	$ 1.4

The following components are combinations of the items presented above:

(amounts in millions)	**2007**	2006	2005
Amortization of net actuarial loss	**$ 0.4**	$ 0.1	$ –

With regard to the Beyss plan, the deficit as at March 31, 2007 is $3.2 million ($2.9 million as at March 31, 2006) and this amount is recognized entirely in other long-term liabilities (Note 13) which means that there is no unrecognized amount for this plan. The 2007 net pension cost for this plan is $0.1 million.

Additional information on Canadian-funded pension plan assets – weighted average asset allocations by asset category are as follows:

	Allocation of plan assets at measurement dates	
Asset Category	December 31, 2006	December 31, 2005
Equity securities	65%	63%
Fixed-income securities	35%	37%
Total	100%	100%

The target allocation percentage for equity securities is 63%, which includes a mix of Canadian, U.S. and international equities, and for the fixed-income securities is 37%, which must be rated BBB or higher. Individual asset classes are allowed to fluctuate slightly and are rebalanced regularly. CAE, through its fund managers, is responsible for investing the assets so as to achieve return in line with underlying market indexes. The investment policy has been modified at the end of December 2005 to allow active management of Canadian equities, which represents approximately 35% of the fund.

Netherlands Pension Plan assets are invested through an insurance company, and the asset allocation is approximately 74% in fixed income and 26% in equities.

The asset allocation for the United Kingdom Pension Plan asset is approximately 31% in fixed income and 69% in equities. Additional information on employer contributions:

	Funded Plan		Supplemental Arrangements	
(amounts in millions)	Canadian	Foreign	Canadian	Foreign
Actual contribution – fiscal 2006	$ 10.6	$ 0.9	$ 1.4	$ 0.3
Actual contribution – fiscal 2007	9.7	0.9	1.2	0.3
Expected contribution – fiscal 2008 (unaudited)	9.1	0.9	1.2	0.4

NOTE 23 – EMPLOYEE FUTURE BENEFITS (CONT'D)

Additional information about benefit payments expected to be paid in future years:

	Funded Plans		Supplemental Arrangements	
(amounts in millions)	Canadian	Foreign	Canadian	Foreign
Years ending March 31,				
2008	$ 10.2	$ 0.2	$ 1.2	$ 0.4
2009	10.9	0.4	1.2	0.4
2010	11.7	0.3	1.3	0.4
2011	12.7	0.5	1.4	0.3
2012	13.7	0.8	1.4	0.3
2013 – 2017	84.7	4.5	9.0	1.6

Significant assumptions (weighted average):

	2007		2006	
	Canadian	**Foreign**	Canadian	Foreign
Pension obligations as of March 31:				
Discount rate	**5.25%**	**4.70%**	5.25%	4.15%
Compensation rate increases	**3.50%**	**1.90%**	3.50%	1.80%

Net pension cost:				
Expected return on plan assets	**7.00%**	**5.60%**	6.50%	5.00%
Discount rate	**5.25%**	**4.30%(1)**	6.00%	4.15%
Compensation rate increases	**3.50%**	**1.80%(1)**	4.50%	1.80%

(1) Note that, due to the inclusion of the U.K. plan in 2007, these assumptions are different than those used to value the pension obligation as at March 31, 2006.

For the purpose of calculating the expected return on plan assets, historical and expected future returns were considered separately for each class of assets based on the asset allocation and the investment policy.

The Company measures its benefit obligations and fair value of plan assets for accounting purposes on December 31 of each year. The most recent actuarial valuation of the pension plans for funding purposes was on December 31, 2004 for the Canadian employee funded plans. The next required valuation will be on December 31, 2007 for both funded plans.

An actuarial valuation of the funded United Kingdom plan is made every three years on March 31. The last actuarial valuation was filled on March 31, 2006.

The funded plan in the Netherlands and the three supplemental arrangements are valued annually on December 31.

NOTE 24 – INVESTMENT TAX CREDITS

The Company is subject to a review by the taxation authorities in various jurisdictions. The determination of tax liabilities and investment tax credits (ITCs) recoverable involve certain uncertainties in the interpretation of complex tax regulations. Therefore, the Company provides for potential tax liabilities and ITCs recoverable based on Management's best estimates. Differences between the estimates and the ultimate amounts of taxes and ITCs are recorded in earnings at the time they can be determined. In the first quarter of fiscal 2005, an amount of $11.4 million, net of tax of $4.7 million, of ITCs was recognized in net earnings and $0.4 million was recorded against deferred development costs. These amounts related to the results of reviews by the taxation authorities for fiscal years 2000 to 2002 and to Management's reassessment of its best estimate of potential tax liabilities for the subsequent fiscal years. On a per segment basis, gross ITCs were recognized as follows: Simulation Products/Civil at $9.8 million, Simulation Products/ Military at $4.4 million and discontinued operations at $1.9 million.

For fiscal 2005, the following table provides the earnings from continuing operations before interest and income taxes amounts by segment, including and excluding ITC provisions reversed based on recent tax reviews:

(amounts in millions)	Including ITC Provisions Reversed (1)	Excluding ITC Provisions Reversed (1)
Simulation Products/Civil	$ 7.8	$ (2.0)
Simulation Products/Military	26.5	22.1
	$ 34.3	$ 20.1

(1) Restated (Note 1)

NOTE 25 – RESTRUCTURING COSTS

In fiscal 2004 and 2005, the Company proceeded with three measures intended to restore its profitability, cash flows and return on investment. The first two initiatives were announced at the end of the fourth quarter of fiscal 2004 and were carried out during the first and second quarters of fiscal 2005.

The first initiative resulted in a restructuring charge of $8.2 million that was recorded in the results of the fourth quarter of fiscal 2004. An amount of $0.7 million related to the sale of its Marine Controls segment has been allocated to discontinued operations. The charge included severance and other involuntary termination costs that related mainly to the workforce reduction of approximately 250 employees in the Montreal plant, following the loss of a major simulation equipment contract to a competitor. The complete amount was disbursed during the first and second quarters of fiscal 2005.

The second initiative was designed to integrate a number of functions at certain European training centres. A restructuring charge of $1.8 million, mainly for severance and other costs, was also recorded in the results of the fourth quarter of fiscal 2004. During fiscal 2005, an amount of $1.2 million was disbursed, leaving a provision of $0.6 million, mostly paid during the second quarter of fiscal 2006.

During the fourth quarter of 2005, following a comprehensive review of current performance and the strategic orientation of its operations, the Company announced a broad Restructuring Plan (third initiative) aimed at the elimination of existing duplications between the civil and military segments and the achievement of a more competitive cost structure. The plan, which included a workforce reduction of approximately 450 employees and the closing of redundant facilities, had a significant effect on the Company's operations in Montreal and around the world,

including some European and U.S. training centres. A restructuring charge of $24.5 million, consisting mainly of severance and other related costs, was included in the net earnings (loss) of the fourth quarter of fiscal 2005. Since fiscal 2005, cumulative restructuring charges of $44.6 million, consisting mainly of employee termination costs and other related costs, and including additional expenditures of $1. 2 million incurred this year, have been recorded in the Company's results. The restructuring initiative is substantially completed.

The following table provides the restructuring charge for each reportable segment:

(amounts in millions)	**2007**	2006	2005
Simulation Products/Civil	**$ –**	$ 2.8	$ 7.6
Simulation Products/Military	**–**	4.3	10.8
Training & Services/Civil	**1.2**	11.6	4.9
Training & Services/Military	**–**	0.2	1.2
	$ 1.2	$ 18.9	$ 24.5

NOTE 25 – RESTRUCTURING COSTS (CONT'D)

The continuity of the restructuring provision is as follows:

(amounts in millions)	Employee termination costs	Other costs	Total
Costs charged to expenses	$ 8.7	$ 0.6	$ 9.3
Payments made	(8.2)	(0.5)	(8.7)
Balance of provision as at March 31, 2004	0.5	0.1	0.6
Costs charged to expenses	20.8	3.7	24.5
Payments made	(12.1)	(1.8)	(13.9)
Balance of provision as at March 31, 2005	9.2	2.0	11.2
Costs charged to expenses	12.6	6.3	18.9
Payments made	(9.3)	(7.6)	(16.9)
Foreign exchange	(0.5)	(0.1)	(0.6)
Balance of provision as at March 31, 2006	12.0	0.6	12.6
Reversal of provision	(1.9)	–	(1.9)
Costs charged to expenses	–	3.1	3.1
Payments made	(7.6)	(3.2)	(10.8)
Foreign exchange	0.4	–	0.4
Balance of provision as at March 31, 2007	**$ 2.9**	**$ 0.5**	**$ 3.4**

NOTE 26 – VARIABLE INTEREST ENTITIES

The following table summarizes, by segment, the total assets and total liabilities of the significant variable interest entities (VIEs) in which the Company has a variable interest as at March 31:

(amounts in millions)	**2007**		2006	
	Assets	**Liabilities**	Assets	Liabilities
Training and Services/Civil:				
Sale and leaseback structures				
Air Canada Training Centre – Fiscal 2000	**$ 14.0**	**$ 14.0**	$ 14.7	$ 14.7
Emirates-CAE Flight Training Centre – Fiscal 2002 (1)	**12.5**	**12.5**	13.1	13.1
Toronto Training Centre – Fiscal 2002	**11.9**	**11.9**	12.4	12.4
Denver/Dallas – Fiscal 2003	**54.1**	**54.1**	56.4	56.4
SimuFlite – Fiscal 2004	**76.8**	**76.8**	80.0	80.0
North East Training Centre – Fiscal 2006	**–**	**–**	28.4	28.4

Assets and liabilities of non-consolidated VIEs subject to disclosure	**$**	**169.3**	**$** **169.3**	$ 205.0	$ 205.0
Training and Services/Military:					
Sale and leaseback structures					
Aircrew Training Centre – Fiscal 1998	**$**	**63.7**	**$** **50.0**	$ 56.3	$ 45.9
Consolidated assets and liabilities before allowing for its classification as a VIE and the Company being the primary beneficiary	**$**	**63.7**	**$** **50.0**	$ 56.3	$ 45.9
Simulation Products/Military:					
Partnership arrangements					
Eurofighter Simulation Systems – Fiscal 1999	**$**	**125.8**	**$** **121.7**	$ 221.5	$ 218.2
Assets and liabilities of non-consolidated VIEs subject to disclosure	**$**	**125.8**	**$** **121.7**	$ 221.5	$ 218.2

(1) The sale and leaseback structure was entered into when the asset was located in the Company's Toronto Training Center. The asset has since been relocated. On October 4, 2006, the asset was contributed to the Emirates-CAE Flight Training Centre.

The detailed impact per balance sheet item is as follows as of January 1, 2005:

(amounts in millions)	Consolidated in fiscal 2005
Assets	
Property, plant and equipment	$ 46.9
	$ 46.9
Liabilities	
Accounts payable and accrued liabilities	$ 0.6
Long-term debt (including current portion)	41.3
Future income tax liabilities	1.8
	$ 43.7
Shareholders' Equity	
Retained earnings	$ 3.3
Currency translation adjustment	(0.1)
	$ 46.9

The liabilities recognized as a result of consolidating this VIE do not represent additional claims on the Company's general assets; rather, they represent claims against the specific assets of the consolidated VIE. Conversely, assets recognized as a result of consolidating this VIE do not represent additional assets that could be used to satisfy claims against the Company's general assets. Additionally, the consolidation of this VIE did not result in any change in the underlying tax, legal or credit exposure of the Company.

SALE AND LEASEBACK STRUCTURES

A key element of CAE's finance strategy to support the investment in its civil and military training and services business is the sale and leaseback of certain FFSs 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 structure arrangement can be executed only after the FFS has achieved certification by regulatory authorities (i.e. the simulator is installed and is available to customers for training). The sale and leaseback structures are typically structured as leveraged leases with an owner-participant.

The Company has entered into sale and leaseback arrangements with special purpose entities (SPEs). These arrangements relate to simulators used in the Company's training centres for the military and civil aviation segments. These leases expire at various dates up to 2023, with the exception of one in 2037. Typically, the Company has the option to purchase the equipment at a specific time during the lease terms at a specific purchase price. Some leases include renewal options at the end of the term. In some cases, the Company has provided guarantees for the residual value of the equipment at the expiry date of the leases or at the date the Company exercises its purchase option. Secured long-term debt and third-party equity investors who, in certain cases, benefit from tax incentives finance these SPEs. The equipment serves as collateral for the long-term debt of the SPEs.

The Company's variable interests in these SPEs are solely through fixed purchase price options and residual value guarantees, except for one case where it is in the form of equity and subordinated loan. In another case, the Company also provides administrative services to the SPE in return for a market fee. As at March 31, 2006, the Company also had a variable interest in another specific SPE through the form of a cost

sharing construction agreement. During fiscal 2007, the cost sharing construction agreement has ended and, as a result as at March 31, 2007, the Company no longer has a variable interest in this SPE.

The Company concluded that some of these SPE are VIEs for which CAE is the primary beneficiary of only one as at March 31, 2007 and March 31, 2006. The assets and liabilities of this VIE are fully consolidated into the Company's consolidated financial statements as at March 31, 2007 and March 31, 2006 before allowing for its classification as a VIE and the Company being the primary beneficiary. For all of the other SPEs that are VIEs, the Company is not the primary beneficiary and consolidation is not appropriate under AcG-15. As at March 31, 2007, the Company's maximum potential exposure to losses relating to these non-consolidated SPEs was $47.1 million ($47.7 million in 2006).

PARTNERSHIP ARRANGEMENTS

The Company entered into partnership arrangements to provide manufactured military simulation products as well as training and services for both the military and civil segments.

NOTE 26 – VARIABLE INTEREST ENTITIES (CONT'D)

The Company's involvement with entities, in connection with these partnership arrangements, is mainly through investments in their equity and/or in subordinated loans and through manufacturing and long-term training service contracts. The Company concluded that certain of these entities are VIEs, but the Company is not the primary beneficiary. Accordingly, these entities have not been consolidated. The Company continues to account for these investments under the equity method, recording its share of the net earnings or loss based on the terms of the partnership arrangements. As at March 31, 2007 and 2006, the Company's maximum off-balance sheet exposure to losses related to these non-consolidated VIEs, other than from its contractual obligations, was not material.

NOTE 27 – OPERATING SEGMENTS AND GEOGRAPHIC INFORMATION

The Company elected to organize its businesses based principally on products and services. Effective April 1, 2005, the Company changed its internal organizational structure such that operations are managed through four segments:

(i) Simulation Products/Civil: Designs, manufactures and supplies civil flight simulators, training devices and visual systems.

(ii) Simulation Products/Military: Designs, manufactures and supplies advanced military training products for air, land and sea applications.

(iii) Training & Services/Civil: Provides business and commercial aviation training and related services.

(iv) Training & Services/Military: Supplies military turnkey training and operational solutions, support services, life extensions, systems maintenance and modelling and simulation solutions.

Due to this change, the corresponding items of segment information for earlier periods have been reclassified to conform to the new internal organization. The accounting policies of each segment are the same as those described in Note 1.

Prior to fiscal 2006, the Company's operations were broken down into the following operating segments: Military Simulation & Training (Military), Civil Simulation & Training (Civil) and Marine Controls (Marine) until the latter's disposal in the fourth quarter of fiscal 2005.

RESULTS BY SEGMENT

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

	Simulation Products			Training & Services			Total		
(amounts in millions)	**2007**	2006	2005	**2007**	2006	2005	**2007**	2006	2005
		Restated (Note 1)	Restated (Note 1)		Restated (Note 1)	Restated (Note 1)		Restated (Note 1)	Restated (Note 1)
Civil									
External revenue	**$ 348.1**	$ 257.0	$ 213.4	**$ 336.9**	$ 322.3	$ 306.8	**$ 685.0**	$ 579.3	$ 520.2
Segment Operating Income	**60.4**	29.9	7.8	**64.3**	57.1	39.8	**124.7**	87.0	47.6
Depreciation and amortization									
• Property, plant and equipment	**5.2**	5.5	7.5	**39.5**	36.6	34.9	**44.7**	42.1	42.4

• Intangible and other assets	**4.2**	5.8	4.6	**6.0**	6.7	10.4	**10.2**	12.5	15.0
Capital expenditures	**14.4**	5.7	10.9	**108.1**	87.5	100.6	**122.5**	93.2	111.5
Military									
External revenue	**$ 357.5**	$ 327.4	$ 278.9	**$ 208.2**	$ 200.5	$ 187.1	**$ 565.7**	$ 527.9	$ 466.0
Segment Operating Income	**39.1**	27.0	26.5	**33.7**	18.7	20.8	**72.8**	45.7	47.3
Depreciation and amortization									
• Property, plant and equipment	**6.0**	6.1	8.7	**4.3**	4.3	4.0	**10.3**	10.4	12.7
• Intangible and other assets	**3.0**	7.7	0.7	**2.6**	2.7	4.0	**5.6**	10.4	4.7
Capital expenditures	**5.5**	6.0	4.4	**30.1**	30.9	2.1	**35.6**	36.9	6.5
Total									
External revenue	**$ 705.6**	$ 584.4	$ 492.3	**$ 545.1**	$ 522.8	$ 493.9	**$ 1,250.7**	$ 1,107.2	$ 986.2
Segment Operating Income	**99.5**	56.9	34.3	**98.0**	75.8	60.6	**197.5**	132.7	94.9
Depreciation and amortization									
• Property, plant and equipment	**11.2**	11.6	16.2	**43.8**	40.9	38.9	**55.0**	52.5	55.1
• Intangible and other assets	**7.2**	13.5	5.3	**8.6**	9.4	14.4	**15.8**	22.9	19.7
Capital expenditures	**19.9**	11.7	15.3	**138.2**	118.4	102.7	**158.1**	130.1	118.0

EARNINGS (LOSS) BEFORE INTEREST AND INCOME TAXES

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

(amounts in million)	**2007**	2006	2005
		Restated (Note 1)	Restated (Note 1)
Total Segment Operating Income	**$ 197.5**	$ 132.7	$ 94.9
Foreign exchange gain on the reduction of the investment in certain self-sustaining subsidiaries [(a)]	**–**	5.3	–
Impairment of goodwill, tangible and intangible assets (Note 5)	**–**	–	(443.3)
Restructuring charge (Note 25)	**(1.2)**	(18.9)	(24.5)
Other costs associated with the Restructuring Plan [(b)]	**(6.9)**	(15.1)	–
Earnings (loss) before interest and income taxes	**$ 189.4**	$ 104.0	$ (372.9)

(a) The Company reduced the capitalization of its certain self-sustaining subsidiaries. Accordingly, the corresponding amount of foreign exchange accumulated in the cumulative translation adjustment account was transferred to the Consolidated Statements of Earnings.

(b) Since the beginning of fiscal year 2006, the Company has also incurred incremental costs related to its Restructuring Plan which are included in earnings (loss) according to GAAP. These costs are not included in the Segment Operating Income. A significant portion relates to the re-engineering of the Company's business processes from which a portion is associated with the deployment of the ERP system (excluding the portion capitalized).

The Company also incurred costs related to the review of its strategy and other costs associated with its restructuring activities.

NOTE 27 – OPERATING SEGMENTS AND GEOGRAPHIC INFORMATION (CONT'D)

ASSETS EMPLOYED BY SEGMENT

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

(amounts in millions)	**As at March 31 2007**	As at March 31 2006
Simulation Products/Civil	**$ 188.0**	$ 163.5
Simulation Products/Military	**251.2**	225.2

Training & Services/Civil	**973.8**	833.8
Training & Services/Military	**208.7**	166.7
Total assets employed	**1,621.7**	1,389.2
Assets not included in assets employed	**334.5**	326.9
Total assets	**$ 1,956.2**	$ 1,716.1

GEOGRAPHIC INFORMATION

The Company markets its products and services in over 19 countries. Sales are attributed to countries based on the location of customers.

(amounts in millions)	**2007**	2006	2005
Revenue from external customers			
Canada	**$ 137.5**	$ 100.1	$ 81.4
United States	**398.6**	393.5	413.5
United Kingdom	**98.1**	80.2	85.3
Germany	**153.3**	153.3	110.2
Netherlands	**92.4**	104.6	56.8
Other European countries	**127.1**	41.3	81.1
China	**56.3**	56.4	37.9
United Arab Emirates	**52.5**	61.7	–
Other Asian countries	**70.8**	54.9	31.6
Other countries	**64.1**	61.2	88.4
	$ 1,250.7	$ 1,107.2	$ 986.2

(amounts in millions)	**As at March 31 2007**	As at March 31 2006
Property, plant and equipment, goodwill and intangible assets		
Canada	**$ 145.5**	$ 169.0
United States	**290.1**	296.8
South America	**55.5**	40.9
United Kingdom	**142.8**	100.3
Spain	**89.9**	84.9
Germany	**53.3**	30.1
Netherlands	**140.8**	133.6
Other European countries	**62.7**	65.5
United Arab Emirates	**72.8**	0.4
Asia	**44.1**	25.2
Other countries	**22.0**	7.9
	$ 1,119.5	$ 954.6

NOTE 28 – 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 if its consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP).

As required by the United States Securities and Exchange Commission (SEC), the effect of these principal differences on the Company's consolidated financial statements is described and quantified as follows:

RECONCILIATION OF NET EARNINGS (LOSS) IN CANADIAN GAAP TO U.S. GAAP

Years ended March 31

(amounts in millions, except per share amounts)	Notes	**2007**	2006	2005
			Restated (Note 1)	Restated (Note 1)
Net earnings (loss) in accordance with Canadian GAAP		**$ 127.4**	$ 63.6	$ (199.6)
Results of discontinued operations in accordance with Canadian GAAP		**(1.7)**	(6.0)	104.8
Earnings (loss) from continuing operations in accordance with Canadian GAAP		**129.1**	69.6	(304.4)
Deferred development costs excluding amortization noted below	A	**(3.4)**	(5.4)	3.4
Amortization of deferred development costs	A	**4.8**	13.1	3.9
Deferred pre-operating costs excluding amortization noted below	B	**(6.9)**	2.0	5.6
Amortization of pre-operating costs	B	**3.0**	4.0	6.1
Financial instruments	C, M	**7.0**	7.9	(4.8)
Variable interest entities	G	**–**	–	1.1
Reduction of the net investment in self–sustaining operations	H	**–**	(5.3)	–
Goodwill impairment	E	**–**	–	(11.6)
Stock-based compensation	L	**5.2**	2.2	(0.1)
Future income tax relating to the above adjustments		**(2.9)**	(7.6)	2.4
Earnings (loss) from continuing operations before cumulative effect of accounting change – U.S. GAAP		**$ 135.9**	$ 80.5	$ (298.4)
Results of discontinued operations in accordance with U.S. GAAP	A, B, C, H	**(1.7)**	(6.0)	98.9
Net earnings (loss) before cumulative effect of accounting change – U.S. GAAP		**$ 134.2**	$ 74.5	$ (199.5)
Cumulative effect of accounting change on prior years	D, G	**–**	–	(0.6)
Net earnings (loss) in accordance with U.S. GAAP		**$ 134.2**	$ 74.5	$ (200.1)
Basic and diluted earnings (loss) per share from continuing operations in accordance with U.S. GAAP		**$ 0.54**	$ 0.32	$ (1.21)
Basic and diluted results per share from discontinued operations in accordance with U.S. GAAP		**$ (0.01)**	$ (0.02)	$ 0.40
Basic and diluted net earnings (loss) per share before cumulative effect of accounting change in accordance with U.S. GAAP		**$ 0.53**	$ 0.30	$ (0.81)
Basic and diluted net earnings (loss) per share in accordance with U.S. GAAP		**$ 0.53**	$ 0.30	$ (0.81)
Dividends per common share		**$ 0.04**	$ 0.04	$ 0.10
Weighted average number of common shares outstanding (basic)		**251.1**	249.8	247.1
Weighted average number of common shares outstanding (diluted)		**253.0**	252.1	247.9

NOTE 28 – DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (CONT'D)

COMPREHENSIVE INCOME

Years ended March 31

(amounts in millions)	Notes	**2007**	2006	2005

Net earnings (loss) in accordance with U.S. GAAP		**$ 134.2**	$ 74.5	$ (200.1)
Change in accumulated minimum pension liability, net of taxes expense of $5.3; 2006 – net of tax recovery of $0.1; 2005 – net of tax recovery of $1.7	J	**11.7**	(0.1)	(4.2)
Change in foreign currency translation adjustments	G, H, I	**27.5**	(43.6)	(41.3)
Comprehensive income		**$ 173.4**	$ 30.8	$ (245.6)

ACCUMULATED OTHER COMPREHENSIVE LOSS IN ACCORDANCE WITH U.S. GAAP

Years ended March 31

(amounts in millions)	Notes	**2007**	2006	2005
Accumulated other comprehensive loss at beginning of year		**$ (122.0)**	$ (78.3)	$ (32.8)
Foreign currency translation adjustment	H	**27.5**	(43.6)	(41.3)
Change in minimum pension liability	J	**11.7**	(0.1)	(4.2)
Unrecognized actuarial gains and losses and past service costs on defined benefit pension plan, net of tax recovery $14.9	J	**(33.0)**	–	–
Accumulated other comprehensive loss at end of year		**$ (115.8)**	$ (122.0)	$ (78.3)

RECONCILIATION OF SHAREHOLDERS' EQUITY IN CANADIAN GAAP TO U.S. GAAP

As at March 31

(amounts in millions)	Notes	**2007**	2006
			Restated (Note 1)
Shareholders' equity in accordance with Canadian GAAP		**$ 829.9**	$ 672.2
Deferred development costs, net of tax recovery of $12.7 (2006 – $13.3)	A	**(12.0)**	(12.8)
Deferred pre-operating costs, net of tax recovery of $4.5 (2006 – $2.9)	B	**(8.6)**	(6.3)
Financial instruments, net of tax recovery of $5.5 (2006 – $7.7)	C, M	**(12.9)**	(17.7)
Defined benefit and other post-retirement benefit, net of tax recovery of $18.0 (2006 – $8.4)	J	**(40.0)**	(18.7)
Stock-based compensation, net of tax expense of $3.3 (2006 – $1.6)	L	**7.0**	3.1
Shareholders' equity in accordance with U.S. GAAP		**$ 763.4**	$ 619.8

CONSOLIDATED BALANCE SHEETS IN ACCORDANCE WITH U.S. GAAP

As at March 31

(amounts in millions)	Notes	**2007**		2006	
		Canadian GAAP	**U.S. GAAP**	Canadian GAAP Restated (Note 1)	U.S. GAAP
Assets					
Current assets					
Cash and cash equivalents		**$ 150.2**	**$ 150.2**	$ 81.1	$ 81.1
Accounts receivable	C	**219.8**	**221.2**	172.6	172.6
Derivative instruments	C	**–**	**8.7**	–	4.5
Inventories	C	**203.8**	**206.0**	180.9	180.9
Prepaid expenses	C	**23.5**	**23.6**	25.2	25.2

Income taxes recoverable		**24.7**		**24.7**		75.7	75.7
Future income taxes	C	**3.7**		**8.4**		5.7	9.1
		$ 625.7		**$ 642.8**	$	541.2	$ 549.1
Property, plant and equipment, net	M	**$ 986.6**		**$ 984.3**	$	832.1	$ 832.1
Future income taxes	A, B, C, E, G, J, L	**81.5**		**125.0**		78.2	109.5
Derivative instruments	C	**–**		**8.6**		–	3.2
Intangible assets	J	**36.0**		**36.0**		30.5	36.1
Goodwill		**96.9**		**96.9**		92.0	92.0
Other assets	A, B, J	**129.5**		**68.2**		136.2	100.9
Long-term assets held for sale		**–**		**–**		5.9	5.9
		$ 1,956.2		**$ 1,961.8**	$	1,716.1	$ 1,728.8
Liabilities and shareholders' equity							
Current liabilities							
Accounts payable and accrued liabilities	C	**$ 403.9**		**$ 404.4**	$	373.7	$ 373.7
Deposits on contracts	C	**184.8**		**187.9**		146.4	146.4
Derivative instruments	C	**–**		**14.8**		–	11.2
Current portion of long-term debt due within one year		**27.2**		**27.2**		10.4	10.4
Future income taxes	C	**4.9**		**8.3**		14.5	15.9
		$ 620.8		**$ 642.6**	$	545.0	$ 557.6
Long-term debt	O	**$ 256.0**		**$ 254.5**	$	260.9	$ 260.9
Deferred gains and other long-term liabilities	C, J, L, M	**232.7**		**251.8**		211.2	239.2
Derivative instruments	C	**–**		**25.3**		–	21.9
Future income taxes	C, L	**16.8**		**24.2**		26.8	29.4
		$ 1,126.3		**$ 1,198.4**	$	1,043.9	$ 1,109.0
Shareholders' Equity							
Capital stock	F, K	**$ 401.7**		**$ 645.9**	$	389.0	$ 633.2
Contributed surplus	L	**5.7**		**6.3**		5.6	5.8
Retained earnings	A, B, C, D, E, F, G, H, K, L	**510.2**		**227.0**		392.8	102.8
Currency translation adjustment	H, I	**(87.7)**		**–**		(115.2)	–
Accumulated other comprehensive loss	H, J	**–**		**(115.8)**		–	(122.0)
		$ 829.9		**$ 763.4**	$	672.2	$ 619.8
		$ 1,956.2		**$ 1,961.8**	$	1,716.1	$ 1,728.8

NOTE 28 – DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (CONT'D)

CONSOLIDATED STATEMENT OF CASH FLOWS

Under U.S. 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 U.S. GAAP is as follows:

Years ended March 31

(amounts in millions)	Notes	**2007**	2006	2005
			Restated (Note 1)	Restated (Note 1)
Net cash provided by operating activities in accordance with Canadian GAAP		**$ 239.3**	$ 228.0	$ 201.0

Deferred development costs	A		**(3.0)**		(1.8)	(9.9)
Deferred pre-operating costs	B		**(5.9)**		(0.7)	(1.7)
Variable interest entities	G		**–**		–	5.6
Deferred pre-operating costs related to discontinued operations	B		**–**		–	(0.4)
Net cash provided by operating activities in accordance with U.S. GAAP		**$**	**230.4**	$	225.5	$ 194.6
Net cash (used in) provided by investing activities in accordance with Canadian GAAP		**$**	**(178.1)**	$	(147.1)	$ 138.2
Deferred development costs	A		**3.0**		1.8	9.9
Deferred pre-operating costs	B		**5.9**		0.7	1.7
Deferred pre-operating costs related to discontinued operations	B		**–**		–	0.4
Net cash (used in) provided by investing activities in accordance with U.S. GAAP		**$**	**(169.2)**	$	(144.6)	$ 150.2
Net cash provided by (used in) financing activities in accordance with Canadian GAAP		**$**	**3.5**	$	(53.2)	$ (337.3)
Variable interest entities	G		**–**		–	(5.6)
Net cash provided by (used in) financing activities in accordance with U.S. GAAP		**$**	**3.5**	$	(53.2)	$ (342.9)

RECONCILIATION ITEMS

A) Deferred development costs

Under U.S. GAAP, development costs are expensed as 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 U.S. 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 (refer to Note 11).

B) Deferred pre-operating costs

Under U.S. GAAP, pre-operating costs are expensed as incurred. Under Canadian GAAP, the amounts are deferred and amortized over five years based on the expected period and pattern of benefit of the deferred expenditures. The difference between U.S. 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 (refer to Note 11).

C) Financial instruments

Derivative financial instruments

Under Canadian GAAP, the Company recognizes the gains and losses on forward contracts entered into for hedging purposes in income concurrently with the recognition of the transactions being hedged. The interest payments relating to swap contracts are recorded in net earnings (loss) over the life of the underlying transaction on an accrual basis as an adjustment to interest income or interest expense. Under U.S. GAAP, all derivatives, including embedded derivatives in host contracts, are recorded on the consolidated balance sheet at fair value. Realized and unrealized gains and losses resulting from the valuation of derivatives at market value are recognized in net (loss) earnings 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 Statement of Financial Accounting Standards (SFAS) 133, 138 and 149.

Interest rate swap

Under Canadian GAAP, the deferred gain on interest rate swaps are amortized against the interest expense of the relevant long-term debt over the remaining terms of the swaps. Under U.S. GAAP, the interest rate swaps do not qualify for hedge accounting and are recorded on the consolidated balance sheet at fair value. As a result, the amortization of the deferred gain on interest rate swaps under Canadian GAAP is reversed for the purposes of U.S. GAAP.

D) Adjustments for changes in accounting policies

Under U.S. GAAP, the cumulative effect of certain accounting changes had to be included in earnings (loss) in the year of the change. Under Canadian GAAP, the impact is reflected through retained earnings.

E) Goodwill impairment

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 U.S. GAAP, this gain was recorded in earnings. In fiscal 2005, Management performed a comprehensive review of current performance and strategic orientation of its business units, which led to the review of the carrying amount of certain assets such as the goodwill of Schreiner. Accordingly, an additional impairment charge of $7.9 million (net of tax of $3.7 million) was recorded in earnings as per U.S. GAAP.

F) 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 U.S. GAAP, the reduction of stated capital would not be permitted.

G) Variable interest entities

The Company enters into sale and leaseback arrangements with special purposes entities (SPEs) relating to simulation equipment used in the Company's training centre. Prior to the adoption of Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 46 *Consolidation of Variable Interest Entities*, the Company consolidated SPEs when their legal stated capital represented less than 3% of their assets. Under those rules, three SPEs were consolidated.

In January 2003, the FASB issued FIN 46, *Consolidation of Variable Interest Entities.* This interpretation clarifies how to apply Accounting Research Bulletin (ARB) 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 subje ct to specific disclosure requirements.

In December 2003, the FASB revised FIN 46 (FIN 46R) to make certain technical corrections and address certain implementation issues that had arisen. FIN 46R provided a new framework for identifying Variable Interest Entities (VIEs) and for determining when a company should include the assets, liabilities, non-controlling interests and results of activities of a VIE in its consolidated financial statements. The Company was required to replace FIN 46 provisions with FIN 46R provisions to all newly created post-January 31, 2003 entities as at the end of the first period ending after March 15, 2005. Beginning April 1, 2004, as a foreign private issuer, the company applied the provisions of FIN 46R to entities created before February 1, 2003. The Company adopted FIN 46R on April 1, 2004.

The Company, upon adoption of FIN 46R, concluded that two out of the three SPEs that were consolidated under the old rules were no longer required to be consolidated. The impact on the Company's net earnings (loss) of the deconsolidation was $0.6 million.

A similar accounting standard under Canadian GAAP, AcG 15, *Consolidation of Variable Interest Entities*, has been adopted by the Company on January 1, 2005. Due to a different application date between Canadian and U.S. GAAP, the Company had to record, in fiscal 2005, a decrease of $0.6 million (net of taxes of $0.5 million) in its net earnings (loss) as per U.S. GAAP.

In fiscal 2006, the Company decided to repurchase the asset (simulator) previously included in the consolidated VIE thereby eliminating the requirement to consolidate the VIE in the Company's consolidated financial statement, under the variable interest entity notion.

H) Foreign currency translation adjustment

Under U.S. GAAP, foreign currency translation adjustment is included as a component of comprehensive income. Under Canadian GAAP, the concept of comprehensive income will be applicable, for the Company, starting on April 1, 2007 and until the application of the new standards, the currency translation adjustment is included as a component of shareholders' equity. In fiscal 2006, the Company transferred to consolidated earnings (loss) an amount of $5.3 million (2005 – $6.6 million, included in results of discontinued operations) as a result of reductions in net investments in self-sustaining foreign operations. Under U.S. GAAP the reduction in currency translation adjustment account is not permitted.

I) Comprehensive income

U. S. GAAP requires disclosure of comprehensive income, which includes net income and other comprehensive income. Other comprehensive income includes currency translation adjustments, change in minimum pension liability and defined benefit and other post-retirement adjustment. Under Canadian GAAP, the requirement to report comprehensive income will be applicable for the Company on April 1, 2007.

NOTE 28 – DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (CONT'D)

J) Defined benefit and other post-retirement benefit

Until the application of FAS 158, *Accounting for Defined Benefit Plans and Other Post-Retirement Benefits – an amendment of FAS Statements No. 87, 88 ,106 and 132(R)*, the provisions under U.S. GAAP of FAS 87, *Employers' Accounting for Pensions*, required that 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 consolidated 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 currently exist under Canadian GAAP.

During fiscal 2007, the Company prospectively adopted FAS 158. Under this statement, the over-funded or under-funded status of a defined benefit pension and other post-retirement benefit plans must be recognized as an asset or liability on the consolidated balance sheet. Any unrecognized actuarial gains or losses, prior service cost or credits and unrecognized net transitional assets or obligations must be recognized as a component of accumulated other comprehensive income. This concept does not currently 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. In fiscal 2004, the Company included share issued costs of $5.1 million into its retained earnings. Under U.S. GAAP, these costs were recorded as a reduction of capital stock.

L) Stock-based compensation

Under Canadian GAAP, the Company has adopted EIC-162 in the third quarter of fiscal 2007, with restatement of prior periods. Under U.S. GAAP, the Company adopted SFAS No. 123R (revised 2004), *Share-Based Payment*, on April 1, 2006, which has the same requirements as EIC-162 under Canadian GAAP except FAS 123R is to be applied prospectively from April 1, 2006 to new option awards that have retirement eligibility provisions. Consequently, this creates a discrepancy in the compensation expense reported in each year.

M) Interest on Receivables and Payables

Under U.S. GAAP, when evaluating the fair value of a non-interest bearing note payable, a current market interest rate for transactions with similar terms should be used for the discounting.

N) Accounting for joint ventures

U.S. GAAP requires the Company's investments in joint ventures to be accounted for using the equity method. However, under an accommodation of the SEC, accounting for joint ventures need not to be reconciled from Canadian to U.S. GAAP. The different accounting treatment affects only display and classification and not earnings or shareholders' equity.

O) Transaction costs

Under Canadian GAAP, transaction costs on long-term debt are presented in Other assets as a deferred charge. U.S. GAAP requires that transaction costs be reported as a direct reduction of long-term debt.

ACCOUNTING CHANGES

Accounting for stock-based compensation

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 (loss), basic earnings (loss) per share and diluted earnings (loss) per share using the fair value method of accounting for stock-based compensation granted prior to April 1, 2003.

Pro forma net earnings (loss) and pro forma basic and diluted net earnings (loss) per share are presented as follows:

(amounts in millions, except per share amounts)	**2007**	2006	2005
Net earnings (loss), as reported per U.S. GAAP	**$ 134.2**	$ 74.5	$ (200.1)
Additional compensation expense recorded	**3.0**	2.5	2.0
Net earnings (loss) before the effect of stock-based compensation	**137.2**	77.0	(198.1)
Pro forma impact	**(3.0)**	(4.2)	(6.4)
Pro forma net earnings (loss)	**134.2**	72.8	(204.5)
Pro forma basic and diluted net earnings (loss) per share	**0.53**	0.29	(0.83)

Under Canadian GAAP, as described in Note 1, the Company has adopted EIC-162 in the third quarter of fiscal 2007, with restatement of prior

periods. EIC-162 requires that the stock-based compensation expense for employees who will become eligible for retirement during the vesting period be recognized over the period from grant date to the date the employee becomes eligible to retire. In addition, if an employee is eligible to retire on the grant date, the compensation expense must be recognized at that date.

Under U.S. GAAP, the Company adopted SFAS No. 123R (revised 2004), *Share-Based Payment*, on April 1, 2006, which has the same requirements as EIC-162 under Canadian GAAP except FAS 123R is to be applied prospectively from April 1, 2006 to new option awards that have retirement eligibility provisions. The nominal vesting period approach is continued for any option awards granted prior to adopting FAS 123R and for the remaining portion of unvested outstanding options.

Inventory Costs

In November 2004, FASB issued SFAS No. 151, *Inventory Costs*, to clarify that abnormal amounts of idle facility expense, freight, handling costs and wasted materials (spoilage) should be recognized as current period charges, and to require the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The guidance was effective for inventory costs incurred during fiscal 2007 and there were no adjustments in the company's consolidated financial statements.

Quantifying Misstatements in the Financial Statements

In September 2006, the SEC Staff issued Staff Accounting Bulletin (SAB) 108, *Quantifying Misstatements in the Financial Statements*. SAB 108 requires that misstatements identified in the current year financial statements which result from misstatements of prior year financial statements be quantified and evaluated using a dual approach that includes both an income statement and balance sheet assessment of any misstatement. The guidance was effective for fiscal years ending after November 15, 2006 and there were no adjustments in the company's consolidated financial statements.

Defined benefit pension and other postretirement plans

In September 2006, the FASB issued FAS 158. FAS 158 requires an entity to: (i) recognize the over-funded or under-funded status of a benefit plan as an asset or liability in the balance sheet; (ii) recognize the existing unrecognized net gains and losses, unrecognized prior-service costs and credits, and unrecognized net transition assets or obligations in other comprehensive income; and (iii) measure defined benefit plan assets and obligations as of the year-end balance sheet date. This statement is effective prospectively at the end of fiscal year 2007 in respect to the recognition requirements described in (i) and (ii) above. In regards to the measurement date changes mentioned in (iii) above, the effective date is the end of fiscal year 2009. The effect of implementing FAS 158 is outlined in the table as follows:

As at March 31, 2007

(amounts in millions)

	Amounts prior to adopting FAS 158	Effect of adopting FAS 158	As reported
Assets			
Intangible assets	**$ 0.4**	**$ (0.4)**	**$ –**
Other assets	**24.1**	**(22.0)**	**2.1**
Future income taxes	**3.1**	**14.9**	**18.0**
Liabilities			
Accounts payable and accrued liabilities	**–**	**(1.7)**	**(1.7)**
Deferred gains and other long-term liabilities	**(37.4)**	**(23.8)**	**(61.2)**
Shareholders' Equity			
Accumulated other comprehensive loss	**7.0**	**33.0**	**40.0**

RECENTLY ISSUED ACCOUNTING STANDARDS

Accounting for Uncertainty in Income Taxes

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109 (FIN 48)*. This interpretation prescribes a more likely than not recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of a tax position, classification of a liability for unrecognized tax benefits, accounting for interest and penalties, and expanded income tax disclosures. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of this interpretation on its consolidated financial statements.

Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, to increase consistency and comparability in fair value

measurements and to expand their disclosures. The new standard includes a definition of fair value as well as a framework for measuring fair value. The standard is effective for fiscal periods beginning after November 15, 2007 and should be applied prospectively, except for certain financial instruments where it must be applied retrospectively as a cumulative-effect adjustment to the balance of opening retained earnings in the year of adoption. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

NOTE 28 – DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (CONT'D)

The Fair Value Option for Financial Assets and Financial Liabilities

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, including an amendment of FASB Statement No. 115. This statement permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective on April 1, 2008. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

Accounting for Servicing of Financial Assets

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets*. The new standard, which is an amendment to SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities – a replacement of FASB Statement No. 125*, requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable and permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. If an entity uses derivative instruments to mitigate the risks inherent in servicing assets and servicing liabilities, it can simplify its accounting since SFAS No. 156 permits income statement recognition of the potential offsetting changes in fair va lue of those servicing assets and servicing liabilities and derivative instruments in the same accounting period. SFAS No. 156 is effective for all separately recognized servicing assets and liabilities acquired or issued after the beginning of an entity's fiscal year that begins after September 15, 2006. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

ADDITIONAL U.S. GAAP DISCLOSURES

i) Statements of earnings

Years ended March 31

(amounts in millions)	**2007**		2006		2005	
	Canadian GAAP	**U.S. GAAP**	Canadian GAAP	U.S. GAAP	Canadian GAAP	U.S. GAAP
Revenues from sales of simulators (1)	**$ 705.6**	**$ 699.0**	$ 584.4	$ 584.4	$ 492.3	$ 489.4
Revenues from sales of training and services (1)	**$ 545.1**	**$ 545.4**	$ 522.8	$ 522.8	$ 493.9	$ 493.9
Cost of sales from simulators	**$ 427.5**	**$ 427.5**	$ 386.8	$ 386.8	$ 332.1	$ 332.1
Cost of sales from training and services	**$ 308.8**	**$ 312.7**	$ 314.2	$ 308.2	$ 284.3	$ 268.8
Research and development expenses (2)	**$ 80.3**	**$ 78.9**	$ 62.6	$ 54.9	$ 55.7	$ 63.0
Rental expenses	**$ 72.6**	**$ 72.6**	$ 80.5	$ 80.5	$ 94.0	$ 94.0
Selling, general and administrative expenses	**$ 166.9**	**$ 161.7**	$ 133.5	$ 131.3	$ 122.7	$ 122.8
Foreign exchange gain	**$ (2.9)**	**$ (15.4)**	$ (8.4)	$ (10.7)	$ (5.2)	$ (2.5)
Impairment charges	**$ –**	**$ –**	$ –	$ –	$ 443.3	$ 440.4
Interest expense	**$ 10.6**	**$ 9.8**	$ 16.2	$ 15.9	$ 32.1	$ 33.9

(1) Taxes assessed by government authorities that are directly imposed on revenue-producing transactions between the Company and customers are excluded from revenues.

(2) Research and development expense is before governments' contribution.

ii) Balance sheet

Accounts payable and accrued liabilities on a U.S. GAAP basis are presented as follows:

As at March 31

(amounts in millions)	**2007**	2006

Accounts payable trade	**$**	**166.8**	$	133.6
Contract liabilities		**71.1**		88.7
Income tax payable		**8.6**		2.5
Other accrued liabilities		**157.9**		148.9
Accounts payable and accrued liabilities	**$**	**404.4**	$	373.7

Accounts receivable from governments amounted to $62.7 million as of March 31, 2007 (2006 – $51.2 million).

iii) Income taxes

The components of earnings (loss) before income taxes and income taxes on a Canadian GAAP basis are as follows:

Years ended March 31

(amounts in millions)		**2007**		2006		2005
Earnings (loss) before income taxes						
Canada	**$**	**38.8**	$	(19.0)	$	(86.9)
Other countries		**140.0**		106.8		(318.1)
	$	**178.8**	$	87.8	$	(405.0)
Current income taxes						
Canada	**$**	**53.8**	$	4.2	$	(1.8)
Other countries		**10.1**		8.9		15.3
	$	**63.9**	$	13.1	$	13.5
Future income taxes						
Canada	**$**	**(41.2)**	$	(7.0)	$	(26.0)
Other countries		**27.0**		12.1		(88.1)
	$	**(14.2)**	$	5.1	$	(114.1)
Total income tax expense (recovery)	**$**	**49.7**	$	18.2	$	(100.6)

iv) Product warranty costs

The Company has warranty obligations in connection to the sale of its civil and military simulators. 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 change in the Company's accrued warranty liability on a Canadian and U.S. GAAP basis, is as follows:

As at March 31

(amounts in millions)		**2007**		2006
Accrued warranty liability at beginning of year	**$**	**8.7**	$	5.3
Warranty settlements during the year		**(5.2)**		(4.1)
Warranty provisions		**6.8**		6.9
Adjustments for changes in estimates		**0.4**		0.6
Accrued warranty liability at the end of year	**$**	**10.7**	$	8.7

v) Impairment of goodwill, tangible and intangible assets

During fiscal 2005, the Company recorded an impairment charge of $443.3 million as per Canadian GAAP. For U.S. GAAP purposes, the impairment was different as the Company expenses development and pre-operating costs when incurred and because the carrying amount of

goodwill is different for Canadian and U.S. GAAP (refer to E).

Accordingly, the Company recorded a $440.4 million impairment charge for U.S. GAAP purposes, virtually all related to its Civil business, detailed as follows:

(amounts in millions)	2005
Goodwill	$216.8
Customer relations	86.7
Trade names	20.4
Property, plant and equipment (simulators)	78.4
Inventories	33.3
Other assets	4.8
	$440.4

NOTE 29 – COMPARATIVE FINANCIAL STATEMENTS

The comparative Consolidated Financial Statements have been reclassified from statements previously presented to conform to the presentation adopted in the current year.

NOTE 30 – SUBSEQUENT EVENTS

ENGENUITY

In April 2007, the Company acquired 14,948,215 common shares of Engenuity Technologies Inc. (Engenuity) representing approximately 85.7% of the total outstanding number thereof. On May 25 2007, the holders of common shares of Engenuity adopted a special resolution approving the amalgamation of Engenuity with 4341392 Canada Inc., a wholly-owned subsidiary of CAE Inc. per the amalgamation agreement. As a result, Engenuity became a wholly-owned subsidiary of CAE Inc. Engenuity develops commercial-off-the-shelf (COTS) simulation and visualization software for the aerospace and defence markets. Total consideration for this acquisition, including acquisition costs, amounted to $23.4 million in cash.

The preliminary fair value of net assets acquired are summarized as follows:

(amounts in millions)		
Current assets [(1)]	$	6.4
Current liabilities		(10.4)
Property, plant and equipment		1.5
Other assets		7.4
Intangible assets		8.7
Goodwill[(2)]		11.8
Long-term liabilities		(4.5)
Fair value of net assets acquired, excluding cash position at acquisition		20.9
Cash position at acquisition		2.5
Total consideration:	$	23.4

(1) Excluding cash on hand

(2) This goodwill is not deductible for tax purposes

The allocation of the purchase price is based on Management's best estimate of the fair value of assets and liabilities. Allocation involves a number of estimates as well as the gathering of information over a number of months. The allocation of the purchase price is preliminary and is expected to be completed in the near future. The net assets of Engenuity, excluding income taxes, will be included in both the Simulation Products/Military and Training & Services/Military segment.

MULTIGEN-PARADIGM INC.

In April 2007, the Company signed an agreement with Parallax Capital Partners, LLC and others to acquire MultiGen-Paradigm Inc., for approximately US$16 million in cash. The acquisition was completed in May 2007.

FINANCIAL REPORT

FOR THE FOURTH QUARTER

AND YEAR ENDED MARCH 31, 2007

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MANAGEMENT'S DISCUSSION AND ANALYSIS

May 31, 2007, for the fourth quarter and the year ended March 31, 2007

1. HIGHLIGHTS

FINANCIAL

FOURTH QUARTER OF FISCAL 2007

Higher revenue over last quarter and year over year

- Consolidated revenue was $337.3 million this quarter, $6.1 million higher than last quarter and $53.0 million higher than the same quarter last year.

Higher earnings, net earnings and earnings per share year over year

- Earnings from continuing operations were $35.1 million (or $0.14 per share) this quarter, compared to $29.7 million (or $0.12 per share) last quarter, and $14.6 million (or $0.06 per share) in the fourth quarter of last year.
- These numbers excluding non-recurring items [1] were $35.1 million (or $0.14 per share) this quarter, $32.0 million (or $0.13 per share) last quarter and $23.0 million (or $0.09 per share) in the fourth quarter of last year.

Positive free cash flow [2] at $52.8 million

- Net cash from continuing operations was $92.2 million this quarter, compared to $76.0 million last quarter and $67.5 million in the fourth

quarter of last year.
- Capital expenditures were $33.8 million this quarter, compared to $42.7 million last quarter and $42.3 million in the fourth quarter of last year.

FISCAL 2007

Higher revenue year over year

• Consolidated revenue was $1,250.7 million this year, $143.5 million or 13% higher than last year.

Higher earnings, net earnings and earnings per share

- Earnings from continuing operations were $129.1 million (or $0.51 per share) this year, compared to $69.6 million (or $0.28 per share) last year.
- These numbers, excluding non-recurring items, were $129.3 million (or $0.51 per share) this year, compared to $85.5 million (or $0.35 per share) last year.

Positive free cash flow at $93.6 million

- Net cash from continuing operations was $239.3 million this year, compared to $225.9 million last year.
- Capital expenditures were $158.1 million this year, compared to $130.1 million last year.

Capital employed[3] is higher in support of growth initiatives

- Capital employed increased by 12% or $100.5 million this year, ending at $962.9 million.
- Non-cash working capital[4] decreased by $37.4 million in fiscal 2007, ending at negative $111.9 million.
- Net debt[5]decreased by $57.2 million this year, ending at $133.0 million.

ORDERS

- Total order intake was $1,455.2 million, up 17% over last year.
- Total backlog[6]was $2,774.6 million as at March 31, 2007, 13% higher than last year.

Civil segments

Simulation Products/Civil won over $400 million of orders including 34 full-flight simulators (FFSs)

A320 FFSs

- One to Air Deccan
- One to Clark Institute
- Three to Flight Simulation Company
- One to Lufthansa Flight Training
- One to Shanghai Eastern Flight Training

[1]Non-G AAP measure (see Section 3.7) .
[2]Non-G AAP measure (see Section 3.7) .
[3]Non-G AAP measure (see Section 3.7) .
[4]Non-G AAP measure (see Section 3.7) .
[5]Non-G AAP measure (see Section 3.7) .
[6]Non-G AAP measure (see Section 3.7) .

A320 FFS-5200
• One to Lufthansa

A330/340 FFSs

- One to Jet Airways
- One to Air China

B737 FFSs

- Four to Flight Simulation Company
- One to KLM
- One to Ryanair

- One to Air China
- One to Continental Airlines

B737 FFS-5200
• Five to Ryanair

B777 FFSs

- One to Air Canada
- One to Cathay Pacific
- One to Jet Airways
- Two to an undisclosed customer

B787 FFSs

- One to China Eastern
- Two to Qantas

Other

- One B747 FFS to United Parcel Service
- One ATR 72-500 FFS to Air Deccan
- One EMB-170 FFS to Flight Training Finance

Training & Services/Civil awarded over $450 million in contracts

- Signed over 50 new business aviation training contracts with many Fortune 1000 companies, government entities and the U.S. Navy.
- Signed over 20 new commercial and regional aviation training contracts with airlines around the world.
- Renewed a number of existing contracts.
- Launched CAE Global Academy, a new training alliance designed to address the global shortage of pilots. CAE Global Academy now has six schools located in Europe, Malaysia, the U.S. and Canada.
- Extended a four-year training contract with Flight Options, valued at approximately $33 million. We will continue to be the exclusive provider of all Flight Options pilot training through 2010.
- Signed a series of contracts valued at more than $10 million for pilot training for new customers at the Dubai training centre.

Military segments

Simulation Products/Military won orders for more than $400 million for new training systems and upgrades

Simulators and upgrades

- Various C130J simulator upgrades for the USAF.
- One AW139 helicopter flight simulator for AgustaWestland.
- Design and development of various upgrades for the German Air Force's Tornado simulators.
- One EH101 full crew mission simulator (FCMS) for the Italian Navy.
- Design and development of various upgrades for the United States Special Operations' MH-47 and MH-60 full mission simulators (FMS) under the ASTARS program.
- Design and development of an upgrade to the British Navy's CAE-built Lynx MK8 full mission simulator.

Trainers and upgrades and training devices

- One C130J fuselage trainer (FuT) for the United States Air Force (USAF).
- Part Task Trainer (PTT) for EADS CASA's multi-role tanker transport aircraft to be used by the Royal Australian Air Force.
- One MH-60R and one SH-60B tactical operational flight trainer (TOFT) for the U.S. Navy.
- One E-6B operational flight trainer (OFT) to be used by the U.S. Navy.
- 36 warrior gunnery turret trainers for the British Army.
- One P-3C operational tactics trainer (OTT) for the German Navy.
- One UH-145 cockpit procedural trainer (CPT) for the United States Army.
- One NH90 virtual maintenance trainer (VMT) for the German Air Force.
- One Lynx crew procedures trainer (LCPT) for the U.K. Royal Navy.

- A range of upgrades on the CAE-built U.K. Royal Navy's EH101 Merlin Training System.
- An upgrade to the British Army's Artillery Fire Control Trainers.
- Design and development of upgrades and new training devices for the U.S. Air Force C-130 Avionics Modernization Program (AMP).

- Design and development of two EC 135 flight training devices (FTDs) for use at Eurocopter training center in Germany and the United States.

Other

- Tornado visual system integration for the German Air Force.
- Design and development of an upgrade for the British Army's Warrior Operational Platform Vehicle (OPV).

Training & Services/Military awarded contracts for $175 million

- One-year contract to continue providing avionic software upgrades, integrated logistics support and data management services for the Canadian Forces' CF-18 aircraft.
- Four-and-a-half year contract to provide on-site maintenance and support services for the U.K. Royal Air Forces' C-130J training systems at RAF Lyneham.
- Maintenance and support services for the U.K. Royal Navy's EH101 Merlin Training System.
- Logistic support services for the British Army's warrior gunnery turret trainers.
- Training and maintenance support services for the United States Air Force C-130J, C-130E/H, and Predator Remote Operated Aircraft (ROA) programs.
- Renewal of a yearly maintenance service contract for various German bases.
- Engineering development services to support a range of new homeland security initiatives across Canada.
- Engineering support services for the U.S. Marine Corp's AV-8B and KC-130 training devices in Cherry Point, North Carolina and Yuma, Arizona.
- Professional engineering and project management services to Canada's Department of National Defence (DND) under the Technical Investigation and Engineering Services (TIES) program.
- Renewal of a range of support services for all German Armed Forces' flight simulators, including Eurofighter, Tornado and P-3C Orion training devices, as well as helicopter simulators located at the German Army Aviation School at Bueckeburg.

PRODUCTS

- We launched a breakthrough product, the CAE 5000 Series full-flight simulator. This new product addresses training requirements for high-volume commercial narrow-body aircraft such as the B737 and the A320, as well as the business jet market including the emerging very light jets (VLJs).
- The new CAE 5000 Series is a complementary product between the CAE Simfinity® line of training devices and CAE's existing, customized Level D simulator, which has also been enhanced and upgraded with the latest technologies and is now called the CAE 7000 Series.

RESTRUCTURING ACTIVITIES ANNOUNCED IN FEBRUARY 2005

- We completed the rationalization of our Montreal footprint.
- This quarter marked the end of the restructuring activities for TS/C, which included:
  - relocating a total of 22 FFSs and retiring or selling five FFSs. We relocated or finished relocating 15 FFSs in fiscal 2007 (including seven in the fourth quarter) with one remaining FFS to be relocated in fiscal 2008, the costs of which will be absorbed in our continuing operations results.
  - closing training centres in six locations. Only the Alcala centre, Maastricht flight school and Dallas facility were closed in fiscal 2007.
  - streamlining the organization by reducing layers of management.
- On March 14, 2007, CAE and Iberia Airlines officially opened the new wing of the CAE Aviation Training Centre in Madrid, giving customers access to 11 full-flight simulators (FFSs).
- We implemented the first phase of our new enterprise resource planning (ERP) system this year in seven of the countries where TS/C operates training centres.
- We introduced a number of operational initiatives to improve our processes and increase operational efficiencies as part of TS/C's Six Sigma initiative.

ACQUISITIONS AND JOINT VENTURES

- Acquired KESEM International Pty Ltd., an Australian simulation and modelling company, on December 22, 2006.
- Formalized the Emirates-CAE Flight Training Center (ECFT) by creating a joint venture company.
- Announced our intention in February 2007 to acquire all of the issued and outstanding shares of Engenuity Technologies Inc. (Engenuity). Following a special meeting of Engenuity shareholders on May 25, 2007, Engenuity merged with CAE's subsidiary 4341392 Canada Inc.
- Signed an agreement in April (after the end of the fiscal 2007) with Parallax Capital Partners, LLC and others to acquire MultiGen-

Paradigm Inc. The acquisition was completed in May 2007.

2. INTRODUCTION

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

- *This year* and *2007* mean the fiscal year ending March 31, 2007.
- *Last year, prior year* and *a year ago* mean the fiscal year ended March 31, 2006.
- Dollar amounts are in Canadian dollars.

This report was prepared as of May 31, 2007, and includes our management's discussion and analysis (MD&A), financial statements and notes for the year and the three-month period ended March 31, 2007. We have written it to help you understand our business, performance and financial condition for fiscal 2007.

The MD&A provides you with a view of CAE as seen through the eyes of management and helps you understand the company from a variety of perspectives:

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

Except as otherwise indicated, all financial information has been reported according to Canadian generally accepted accounting principles (GAAP).

For additional information, please refer to our annual consolidated financial statements for this fiscal year, which you will find in this annual report for the year ended March 31, 2007.

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

ABOUT MATERIAL INFORMATION

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

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

ABOUT FORWARD-LOOKING STATEMENTS

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

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

Business risk and uncertainty in this MD&A.

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

3. ABOUT CAE

3.1 WHO WE ARE

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

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

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

Founded in 1947 and headquartered in Montreal, CAE has built an excellent reputation and long-standing customer relationships based on 60 years of experience, strong technical capabilities, a highly trained workforce and global reach. More than 5,000 employees work in production and training facilities in 19 countries around the world. Approximately 90% of CAE's annual revenues come from worldwide exports and international activities.

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

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

3.2 OUR VISION

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

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

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

3.3 OUR STRATEGY AND KEY PERFORMANCE DRIVERS

Our strategy

We have transformed ourselves over the past few years, evolving from a supplier of equipment to a provider of integrated training solutions. When our President and Chief Executive Officer joined CAE in August 2004, he launched an in-depth strategic review of our markets, customers and other stakeholders as well as our own internal resources and capabilities.

As a result, we refined our strategic direction by focusing on a wide range of simulation and training products and services for two core markets – civil and military – and selling the Marine Controls division. We also focused on achieving operational synergies, protecting our technological leadership and restoring financial health to ensure our stability and long-term growth.

To achieve this, our 2007 priorities included:

- Complete the remaining elements of our restructuring plan.
- Continue to strengthen relationships with customers and original equipment manufacturers.
- Continue to improve our financial performance.
- Continue to re-engage our employees around the world.
- Maintain our technological leadership.
- Target growth in our core markets.

Complete the remaining elements of our restructuring plan

In February 2005, we announced a formal restructuring plan to achieve our strategy, to leverage our core capabilities and to institute a platform for sustainable, profitable business.

The plan focused on six key areas:

- Consolidating development and production activities such as engineering, program management and global procurement functions which existed in various business units and resulted in duplication of effort.
- Improving initiatives to standardize processes and focus the manufacturing process around our products.
- Rationalizing the civil training centre footprint by consolidating training centres to eliminate duplication and relocate a number of FFSs to maximize yield.
- Optimizing the work force, streamlining the management structure and re-engaging employees.
- Implementing an enterprise resource planning (ERP) system to improve transparency, accountability and information flow.
- Introducing other measures to improve the nature and focus of our operations.

We spent the last two years implementing this plan. While some activities started towards the end of fiscal 2005, fiscal 2006 was a transition year as we revised our business processes and cost structure.

We completed the final elements of the restructuring plan in fiscal 2007 by:

- Reviewing our product and services portfolio to deliver solutions to better meet customers' needs.
- Developing innovative processes that expand our capabilities and technology into new markets.

- Re-engineering business processes related to the implementation of the ERP system.
- Relocating a total of 15 FFSs.
- Closing three locations.
- Implementing an ERP system in seven of the countries where TS/C operates.

Continue to strengthen relationships with customers and original equipment manufacturers

Paramount to CAE's success is ensuring that we develop products and services that help ensure the success and satisfaction of our customers. CAE is focused on listening closely to customers so we can develop innovative solutions designed to enhance safety and efficiency. CAE has established a Customer Advisory Board C AB) and Technical Advisory Board (TAB) specifically to solicit candid feedback and input from our customer base. The CAB and TAB help shape CAE's product and service offerings, and provide valuable insight for future technology developments. For example, both the CAB and TAB had significant input on the development of the new CAE 5000 Series full-flight simulator.

Also, one of our strategic priorities is to develop a competitive training service that is cost effective and increases revenue per simulator and the proportion of training services (*wet training*) versus selling leased time on training devices (*dry training*) in our global network of training centres.

We are pursuing a number of initiatives to help meet the growing demand for trained pilots including:

- Pilot provisioning, our turnkey service that includes recruiting, screening, selection and training to convert experienced pilots
- CAE Global Academy, our new training alliance for pilot candidates launched in the second quarter. We signed a total of six schools during fiscal 2007, and we can now train over 1,000 cadets per year.

This year we announced a training joint venture with Embraer for crews of the new Phenom 100 Very Light Jet (VLJ) and Phenom 300 Light Jet (LJ).

We are continuing to strengthen relationships and partnerships with original equipment manufacturers. For example, EADS CASA selected CAE as its preferred training systems provider for the C-295 aircraft, and we are currently developing C-295 simulators for the EADS CASA training centre in Spain and the Brazilian Air Force. We are also working with EADS CASA to support other C-295 aircraft programs around the world. Boeing selected CAE to provide the training systems for the U.S. Air Force's C-130 Avionics Modernization Program, and Boeing also recognized CAE with its Outstanding Supplier Award for outstanding responsiveness and support during development of new business opportunities.

Continue to improve our financial performance

We are showing earnings growth, positive steady free cashflow and reduction in net debt. We also reduced the manufacturing costs for simulation equipment we sell to third parties and install in our global network of training centres.

We also reduced the cycle time for manufacturing and producing products in modules to help lower costs.

Continue to re-engage our employees around the world

We benefit from an employee base that is diversified, well educated and experienced. We must also have an employee base that is highly engaged. Our commitment to communicate clearly and on a timely basis and to share ideas across levels and functions is critical to this effort.

We have a number of initiatives in place to foster employee engagement around the world, including our *Employee engagement survey*, forums with the CEO and Group Presidents, focus groups and our new employee recognition program, which was initially piloted among 1,200 engineers and scientists in our Montreal office.

Our *2007 Employee engagement survey* revealed that almost 90% of our employees believe in the value of our products and services. We had a 30% improvement from our 2005 survey, and our results were higher than average for global companies.

Maintain our technological leadership

We continue to invest in new and innovative technologies. Project Phoenix is the $630 million R&D initiative we launched in fiscal 2006 to improve leading-edge technologies and develop new applications that reinforce our industry position as a world leader in simulation, modelling and services.

We consulted with customers to develop innovative products and service solutions that enhance their operational efficiencies and mitigate operational risks.

We made key acquisitions, expanding our modelling and simulation capabilities and R&D efforts in key markets:

Fiscal 2007
• KESEM International Pty Ltd. (KESEM).

Early fiscal 2008

- Engenuity Technologies.
- MultiGen-Paradigm, Inc.

We also launched the CAE 5000 Series full-flight simulator, a breakthrough product designed to meet training requirements for high-volume

commercial narrow-body aircraft, such as the B737 and the A320, and the emerging VLJs in the business jet market. The 5000 Series expands our portfolio of simulation and training solutions, which is already the most comprehensive offering in the industry. We developed the new simulator based on input from customers, our technical advisory boards, our own training instructors and strong and effective coordination with regulatory agencies worldwide.

Target growth in our core markets

There are four elements to our growth initiatives:

- Focusing our civil business on high growth markets such as Asia and the Middle East.
- Increasing the presence of our military segments in the U.S. market.
- Expanding vertically within the aerospace and defence industry into other products and services that require our technological expertise in modelling and simulation.
- Expanding horizontally by leveraging our expertise in modelling and simulation to pursue opportunities in non-traditional areas, such as homeland defence.

We have emerged from our restructuring as a company that is well diversified between products and services and between the civil and military markets. We are now more oriented towards services and technology, and we have a solid financial base and a balanced business. These are key strengths that we plan to sustain and build on as we position ourselves for growth.

Key performance drivers

We have defined 10 key attributes that give us a competitive advantage and drive our performance.

Technological leadership

We pride ourselves on our technological leadership. Pilots around the world view our simulation as the closest thing to the true experience of flight. CAE has consistently led the evolution of flight training and simulation systems technology with a number of industry firsts. We have simulated the entire range of large civil aircraft, a large number of the leading regional and business aircraft and a number of civil helicopters. We are an industry leader in providing simulation and training solutions for fixed-wing transport aircraft and helicopter platforms for the military. We also have extensive knowledge, experience and credibility in designing and developing simulators for prototype aircraft of major aircraft manufacturers.

Product design and reliability

We design our simulators so customers can easily upgrade them, giving them more flexibility and opportunity as products change or new air-worthiness regulations are introduced.

Our simulators are typically rated among the highest in the industry for reliability. This is a key benefit because simulators operate in high-duty cycles of up to 20 hours a day.

Long-term customer relationships

Because of our focus on quality of service and our ability to consistently meet or exceed our customers' standards, we have had many long-term relationships with major airlines and ministries of defence around the world – some even spanning decades.

Large and diversified fleet of FFSs

We operate a fleet of over 110 FFSs to meet the wide range of operational requirements of our customers. Our fleet includes FFSs for various types of aircraft from major manufacturers including commercial jets, business jets and military helicopters.

Leveraging synergies between our products and services

Our broad array of flight training products allows us to tailor solutions to each customer's specific requirements, which makes us unique. Our segments work closely together because the sales of training equipment and related services are often part of the same program.

Customer support

We maintain a strong focus on after-sales support, which is often critical in winning additional sales contracts.

Global coverage

We have operations in 19 countries on five continents. This broad geographic coverage allows us to respond quickly and cost effectively to customer needs and new business opportunities while respecting the regulations and customs of the local market.

Training methodology

We revolutionized the way aviation training is performed when we introduced our Simfinity ®-based training solutions and courseware. We achieved wide distribution by installing the high-fidelity simulation software in our FFSs and leveraging this into training devices and solutions that are used throughout the training cycle. This effectively brings the virtual aircraft cockpit into the classroom at the earliest stages of ground school

training, making it a more effective and efficient training experience overall. Because our Simfinity® devices are part of a suite of fully integrated training solutions, customers can use these devices to perform any updates and upgrades.

Capacity to control costs

We continue to focus on becoming more efficient while lowering costs. Successfully controlling costs depends on our ability to obtain the data, equipment, consumables and other supplies that are required to carry out our operations at competitive prices. Our Global Strategic Sourcing group is focusing on improving long-term cost control and sourcing strategies with our major suppliers. They are sharing this knowledge globally across our business and implementing best practices in procurement. They are also analyzing costs to source supplies at the lowest cost over the life of a FFS, and this may lead to developing long-term alliances with some of our suppliers to ensure there is always an adequate supply of materials.

Innovation for the future

Innovation has always been at the heart of our business and success over our 60-year history. It is key to helping chart our future success.

A core group of people have been exploring different opportunities to build on our key strengths and tap new, emerging and adjacent markets to invest in during the year.

Opportunities that build on our technology, leverage customer intimacy and capitalize on our knowledge of training and the development of course curriculum are the main focus.

We are also exploring other areas such as medical simulation, transportation and others, where our existing capabilities can help other markets mitigate risks, guide decision-making and create operational efficiencies.

3.4 CAPABILITY TO EXECUTE STRATEGY AND DELIVER RESULTS

Our resources and processes ensure we can carry out our strategy and deliver results. We have two other attributes that are critical to our success:

Our financial position

At March 31, 2007, our net debt was $133.0 million, representing a net debt to market capitalization ratio of less than 5%. With our strong balance sheet, available credit and the cash we are able to generate from operations, we have adequate funding in place or available to sustain our current development projects. See section 7, *Consolidated financial position* for a more detailed discussion.

A skilled workforce and experienced management team

At the end of fiscal 2007, we had more than 5,000 employees. The skills of our workforce have a significant impact on the efficiency and effectiveness of our operations. While competition for well-trained and skilled employees is high, we have been successful at attracting and retaining people because of our quality reputation as an industry leader and our commitment to providing an engaging and challenging work environment and by offering competitive compensation.

We also have an experienced management team with a proven track record in the aerospace industry. Strong leadership and governance are critical to the successful implementation of our corporate strategy. We are focusing on leadership development of key executives and members of senior management.

3.5 OUR OPERATIONS

CAE serves two markets globally:

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

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

CIVIL MARKET

Simulation Products/Civil (SP/C)

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

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

Training & Services/Civil (TS/C)

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

Our TS/C segment is the second largest provider of civil aviation training services in the world, and serves all sectors of the market including general aviation, regional airlines, commercial airlines and business aviation. We also offer a full range of support services, such as training centre management, simulator maintenance services, spare parts and inventory management, curriculum development and consulting services. We have achieved our leading position through acquisitions, joint ventures and by building

new facilities. We currently have more than 110 FFSs installed in 24 training centres around the world. We intend to increase the number of RSEUs in our network to maintain our position and address new market opportunities. We are developing our training network to meet the long-term, steady stream of recurring training needs so we rely less on new aircraft deliveries to drive revenue.

Market trends and outlook

We continue to have a positive outlook for the civil market because of the following trends:

- Positive economic indicators
- Continued growth in revenue per passenger kilometre
- Strong aircraft orders and new platforms
- Growing demand for trained pilots.

Positive economic indicators

GDP and growth in corporate profits driving business aviation market

Business aviation is experiencing a strong and growing training market because fleets are active, projections for business jet deliveries are high and new operators are entering the market. We expect the development of the very light jet (VLJ) and light jet (LJ) segments to lead to opportunities for training and other services in the future.

New and emerging markets

Emerging markets such as Asia-Pacific, the Indian sub-continent and the Middle East continue to experience high growth in air traffic, strong economic growth and an increasing liberalization of air policy and bilateral air agreements. We expect these markets to drive the demand for FFSs and training centres.

Continued growth in revenue per passenger kilometre

Steady growth in air travel

We anticipate the long-term, steady growth in passenger traffic that recently recommenced and to continue for the foreseeable future. We expect this to be slightly above the average annual growth from 1995 to 2005 of 5.2% . This is barring any major developments such as excessive fuel prices, regional political instability, acts of terrorism, pandemics or other world events.

Continued growth of low-cost airlines

The growth of low-cost airlines continues to be a major factor driving activity in the civil aviation market, and the demand for simulation products and training services. In 2006, low-cost airlines represented more than 27% of capacity in the U.S., and more than 24% in Europe. These percentages are expected to grow as low-cost airlines expand their fleets. In the Asia-Pacific region, low-cost airlines represented just 9% of capacity in 2006, but this represents a jump of over 55% from 2005. CAE clients such as Ryanair and IndiGo are representative of low-cost carriers expanding their fleets and capacity, thus spurring increasing demand for pilot training equipment and services.

Slower activity in mature markets

High fuel costs and intense domestic competition are affecting the performance of many commercial airlines in mature markets such as North America. The North American market has started to show two key signs of recovery:

- Some legacy carriers have emerged from Chapter 11 and returned to profitability
- Some airlines have made initial orders to replace their fleets, and we expect this trend to continue for the next few years.

Strong aircraft orders and new platforms

New aircraft platforms

Original equipment manufacturers are introducing new platforms, which will drive worldwide demand for simulators and training. The Boeing 787, Boeing 747-8, Airbus A350XWB, Embraer 190, Embraer Phenom 100 and 300 and the Eclipse 500 VLJs are some recent examples.

New platforms will drive the demand for new kinds of simulators. One of our strategic priorities is to partner with manufacturers to strengthen relationships and position ourselves for future opportunities.

Strong aircraft orders

In calendar 2006, Boeing received a total of 1,044 orders for new aircraft and Airbus received 824 orders. Their strong delivery forecast and increased production of narrow body models are expected to help generate opportunities for our full portfolio of training products and services. It is important to note that deliveries of new model aircrafts are susceptible to delays of program launches, which may affect our deliveries.

Growing demand for trained pilots
Worldwide demand is increasing

Growth in the civil aviation market is continuing to drive the demand for pilots worldwide, which is creating a shortage of qualified pilots. The shortage is even more pronounced because of aging demographics and fewer military pilots transferring to civil airlines. Emerging markets like India and China are experiencing this even more severely because air traffic is growing more quickly there than in developed countries, and there is less infrastructure to meet the current and projected demand for pilots.

This creates opportunities for pilot provisioning, our turnkey service that includes recruiting, screening, selection and training. It is also prompting us to seek out partners to develop a global pipeline for developing and supplying pilots to meet market demand. On July 19, 2006, we launched CAE Global Academy, a new training alliance designed to address the global shortage of pilots. We signed agreements with three Flight Training Organizations (FTOs) this year and added three more FTO members to the CAE Global Academy in April 2007.

New pilot certification process requires simulation-based training

The aviation industry is expected to adopt another certification process for training pilots in 2007. The International Civil Aviation Organization (ICAO) multi-crew pilot licence (MPL) requires more simulation-based training, which we expect to be positive for our business.

MILITARY MARKET

Simulation Products/Military (SP/M)

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

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

Training & Services/Military (TS/M)

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

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

Market trends and outlook

While we expect defence budgets around the world to continue to grow modestly by 2 to 3% a year, we believe that our share of that spending will increase for the following reasons:

- Demand for our type of products and services is growing
- The nature of warfare is changing.

Demand for our type of products and services is growing

New aircraft platforms

One of our strategic priorities is to partner with manufacturers in the military market to strengthen relationships and position ourselves for future opportunities. Original equipment manufacturers are introducing new platforms that will drive worldwide demand for simulators and training. For example, NH Industries is starting to deliver the NH90 helicopter, and EADS CASA is aggressively marketing the C-295 transport worldwide, all of which fuel the demand for new types of simulators.

Trend towards outsourcing

With finite defence budgets and resources, defence forces and governments continue to scrutinize expenditures to find ways to save money and allow active-duty personnel to focus on operational requirements. There has been a growing trend among defence forces to outsource a variety of training services and we expect this trend to continue. Governments are outsourcing training services because they can be delivered more quickly and more cost-effectively.

For example, we won a new contract this year with the United States Marine Corps to provide engineering support services for the AV-8B and KC-130 training systems.

Greater use of simulation

More defence forces and governments are adopting simulation in training programs because it improves realism, significantly lowers costs, reduces operational demands on aircraft, and lowers risk compared to operating actual weapon systems platforms. Using a simulator for training also reduces actual aircraft flying hours and allows training for situations where an actual aircraft and/or its crew and passengers would be at risk.

Extension and upgrade of existing weapon systems platforms

Original equipment manufacturers are extending the life of existing weapon system platforms by introducing upgrades or adding new features, which increases the demand for upgrading simulators to meet the new standards. For example, we won a contract in fiscal 2007 to upgrade the Royal Navy's EH101 Merlin Training System for their maritime patrol helicopters as part of the Merlin Capability Sustainment Programme.

The nature of warfare is changing

Demand for networking

The nature of warfare is changing. Allies are co-operating and creating joint and coalition forces, which is driving the demand for joint and networked training and operations. For example, we received a contract this year to design and manufacture MH-60R tactical operational flight trainers for the U.S. Navy. These devices can be networked to train both flight and rear crews, and support the U.S. Navy's Simulator Master Plan to allow for networked training for their range of platforms.

Growing acceptance of synthetic training

There is a growing trend among defence forces to use synthetic training to meet more of their training requirements. Synthetic environment software allows defence clients to plan sophisticated missions and carry out full mission rehearsals as a complement to traditional live training or mission preparation. Synthetic training offers militaries a cost-effective way to provide realistic training for a wide variety of scenarios while ensuring they maintain a high state of readiness. For example, we are currently fulfilling a contract with the United States Army to deliver a Synthetic Environment Core (SE-Core) Database Virtual Environment Development (DVED).

3.6 FOREIGN EXCHANGE

We believe that disclosing the impact of foreign exchange on our results is useful supplemental information because it allows you to compare performance before the effect of foreign exchange, which can have a significant impact on our operations and financial results.

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

The tables below show the variations of the closing and average exchange rates for our three main operating currencies. The variation in rates lowered this year's earnings from continuing operations (after tax) by approximately $2.4 million compared to fiscal 2006, and partly offset our operational improvements.

We used the foreign exchange rates below to value our assets, liabilities and backlog in Canadian dollars at the end of the last two fiscal years:

	2007	2006	Increase (Decrease)
U.S. dollar (US$ or USD)	**1.1529**	1.1671	(1%)
Euro (€)	**1.5418**	1.4169	9%
British pound (£ or GBP)	**2.2697**	2.0299	12%

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

	2007	2006	Increase (Decrease)
U.S. dollar (US$ or USD)	**1.1385**	1.1938	(5%)
Euro (€)	**1.4598**	1.4553	–
British pound (£ or GBP)	**2.1550**	2.1341	1%

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

- **Our networks of civil and military training centres**
  Most of each network's revenue and costs are in the local currency. Changes in the value of the local currency relative to the Canadian dollar therefore have an impact on a network's net profitability and net investment. Under GAAP, gains or losses in thenet investment in a self-sustaining subsidiary that result from changes in foreign exchange rates are deferred in the cumulativetranslation adjustment C TA) account, which is part of the shareholders' equity section of the balance sheet. Any effect of thefluctuation between currencies on the net profitability has an immediate effect on the earnings statement and an impact onyear-to-year and quarter-to-quarter comparisons.
- **Our manufacturing operations outside of Canada (Germany, U.S ., U.K. and Australia)**
  Most of the revenue and costs in these operations are generated in their local currency except for some data and equipment they buy in different currencies from time to time. Changes in the value of the local currency relative to the Canadian dollar thereforehave an impact

on the operation's net profitability and net investment when expressed in Canadian dollar.

• Our manufacturing operations in Canada

Although the net assets of our Canadian operations are not exposed to changes in the value of foreign currencies (except for receivables and payables in foreign currencies), approximately 85% of our revenue generated from Canada is in foreign currencies (mostly the U.S. dollar and euro), while a significant portion of the expenses is in Canadian dollars.

As a general policy, we hedge the milestone payments in contracts denominated in foreign currencies to protect ourselves from some of the foreign exchange exposure. It is impossible, however, to completely offset the effects of changing foreign currency values, leaving some residual exposure that can affect the statement of earnings.

Our manufacturing operations in Canada are exposed to changes in the value of the Canadian dollar over the long term because we do not enter into hedges of expected future revenues until the contracts are signed. When revenue is translated into Canadian dollars, our revenue and margins can fluctuate.

Sensitivity analysis

We conducted a sensitivity analysis to determine the impact of variations in the value of foreign currencies. We evaluated the sources of foreign currency revenues and expenses and determined that our consolidated exposure to foreign currency mainly occurs in two areas:

- Foreign currency revenues and expenses in Canada for the manufacturing business – we hedge these revenues.
- Translation of foreign currency operations of self-sustaining subsidiaries in foreign countries – this has a natural hedge. Our exposure is mainly in our operating profits.

First we calculated the revenue and expenses per currency to determine the operating income in each currency. Then we subtracted the amount of hedged revenues to determine a net exposure by currency. Next we added the net exposure from the self-sustaining subsidiaries to determine the consolidated foreign exchange exposure in different currencies.

Finally, we conducted a sensitivity analysis to determine the impact of a change of one cent in the Canadian dollar against each of the other four currencies. The table below shows the typical impact of this change, after taxes, on our revenue and operating income, as well as our net exposure:

Exposure *(amounts in millions)*	Revenue	Operating income	Hedging	Net exposure
U.S. dollar (US$ or USD)	5.4	1.8	(1.4)	0.4
Euro (€)	1.9	0.3	(0.2)	0.1
British pound (£ or GBP)	0.4	Not material	Not material	Not material
Australian dollar (AUD$ or AUD)	0.3	Not material	Not material	Not material

3.7 NON-GAAP AND OTHER FINANCIAL MEASURES

This MD&A includes non-GAAP and other financial measures. Non-GAAP measures are useful supplemental information but may not have a standardized meaning according to GAAP. You should not confuse this information with, or use it as an alternative for, performance measures calculated according to GAAP. You should also not use them to compare with similar measures from other companies.

Backlog

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

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

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

Capital employed

Capital employed is a non-GAAP measure we use to monitor how much we are investing in our business. We measure it from two perspectives:

Capital used

- For the company as a whole, we take total assets (not including cash and cash equivalents), and subtract total liabilities (not including long-term debt and its current portion).

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

Sources of capital

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

Maintenance and growth capital expenditure

Maintenance capital expenditure is a non-GAAP measure we use to calculate the capital investment needed to sustain current levels of economic activity.

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

EBIT

Earnings before interest and taxes E BIT) is a non-GAAP measure that shows us how we have performed before the effects of certain financing decisions and tax structures. We track EBIT because we believe it makes it easier to compare our performance with previous periods, and with companies and industries that do not have the same capital structure or tax laws.

Free cash flow

Free cash flow is a non-GAAP measure that tells us how much cash we have available to build the business, repay debt and meet ongoing financial obligations. We use it as an indicator of our financial strength and liquidity. We calculate it by taking the net cash generated by our continuing operating activities, subtracting all capital expenditures (including growth capital expenditures and capitalized costs) and dividends paid, and then adding the proceeds from sale and leaseback arrangements and other asset-specific financing (including non-recourse debt). Dividends are deducted in the calculation of free cash flow because we consider them an obligation, like interest on debt, which means that amount is not available for other uses.

Gross margin

Gross margin is a financial measure equivalent to the segment ope2rating income excluding selling, general and administrative expenses.

Net debt

Net debt is a non-GAAP measure we use to monitor how much debt we have after taking into account liquid assets such as cash and cash equivalents. We use it as an indicator of our overall financial position, and calculate it by taking our total long-term debt (debt that matures in more than one year), including the current portion, and subtracting cash and cash equivalents.

Non-cash working capital

Non-cash working capital is a non-GAAP measure we use to monitor how much money we have tied up in the day-to-day operation of our business. We calculate it by taking current assets (not including cash and cash equivalents or the current portion of assets held for sale) and subtracting current liabilities (not including the current portion of long-term debt or the current portion of liabilities related to assets held for sale).

Non-recourse financing

Non-recourse financing to CAE is a non-GAAP measure we use to classify debt, when recourse against the debt is limited to the assets, equity interest and undertaking of the subsidiary, and not the parent company.

Non-recurring items

Non-recurring items is a non-GAAP measure we use to identify items that are outside the normal course of business because they are infrequent, unusual and/or do not represent a normal trend of the business. We believe that highlighting significant non-recurring items and providing operating results without them is useful supplemental information that allows for a better analysis of our underlying and ongoing operating performance.

Revenue per simulator

Revenue per simulator is a financial measure we calculate by dividing the revenue of TS/C for the period (on an annualized basis) by the related revenue simulator equivalent unit.

Revenue simulator equivalent unit

Revenue simulator equivalent unit (RSEU) is a financial measure we use to show the total number of FFSs available to generate revenue during the period. For example, in the case of a 50/50 flight training joint venture, we will report only 50% of the FFSs deployed under this joint venture as a RSEU. If a FFS is being powered down and relocated, it will not be included as a RSEU until the FFS is re-installed and available to generate revenue.

Segment operating income

Segment operating income (SOI) is a non-GAAP measure and our key indicator of each segment's financial performance. This measure gives us a good indication of the profitability of each segment because it does not include the impact of any items not specifically related to the segment's performance (these items are presented in the reconciliation between total segment operating income and EBIT (see Note 27 to the consolidated financial statement).

4. CONSOLIDATED RESULTS

We have retroactively restated all comparative prior periods to account for a recent change in accounting standards E IC-162:

Stock-Based Compensation for Employees Eligible to Retire Before the Vesting Date). This change was required for all companies under Canadian GAAP for interim and annual financial statements ending on or after December 31, 2006.

You will find more details in section 10, *Changes in accounting standards*.

4.1 RESULTS OF OUR OPERATIONS – FOURTH QUARTER OF FISCAL 2007

Summary of consolidated results

(amounts in millions, except per share amounts)	**Q4-2007**	Q3-2007	Q2-2007	Q1-2007	Q4-2006
Revenue	**$ 337.3**	$ 331.2	$ 280.4	$ 301.8	$ 284.3
Earnings before interest and income taxes (EBIT)	**53.3**	44.2	44.8	47.1	9.1
As a % of revenue	***15.8%***	*13.3%*	*16.0%*	*15.6%*	*3.2%*
Interest expense, net	**3.5**	2.9	1.2	3.0	0.9
Earnings from continuing operations (before taxes)	**$ 49.8**	$ 41.3	$ 43.6	$ 44.1	$ 8.2
Income tax expense (recovery)	**14.7**	11.6	12.3	11.1	(6.4)
Earnings from continuing operations	**$ 35.1**	$ 29.7	$ 31.3	$ 33.0	$ 14.6
Results from discontinued operations	**(0.8)**	–	(0.3)	(0.6)	(5.4)
Net earnings	**$ 34.3**	$ 29.7	$ 31.0	$ 32.4	$ 9.2
Basic and diluted EPS from continuing operations	**0.14**	0.12	0.12	0.13	0.06
Basic and diluted EPS	**0.14**	0.12	0.12	0.13	0.04

We have restated comparable periods to reflect a change in the stock-based compensation expense (EIC-162).

Summary of results excluding non-recurring items

(amounts in millions, except per share amounts)	**Q4-2007**	Q3-2007	Q2-2007	Q1-2007	Q4-2006
Earnings from continuing operations (before taxes)	**$ 48.7**	$ 44.1	$ 43.9	$ 44.4	$ 31.7
Net earnings from continuing operations	**35.1**	32.0	31.2	31.0	23.0
Basic and diluted EPS from continuing operations	**0.14**	0.13	0.12	0.12	0.09

We have restated comparable periods to reflect a change in the stock-based compensation expense (EIC-162).

Revenue was 2% higher than last quarter and 19% higher year over year

Revenue was $6.1 million higher than last quarter even though SP/M revenue decreased by $13.0 million or 12%. SP/C increased its revenue by 6%, TS/C by 10% and TS/M by 10% this quarter while the decrease in SP/M's revenue was mainly because of unusually high activity on some European programs in the third quarter.

All four segments had higher revenue compared to the same period last year:

- SP/C revenue was 25% or $19.6 million higher because of the higher number of new orders.
- SP/M revenue was 19% or $14.7 million higher because of higher activity on some U.S. programs.
- TS/C revenue was 13% or $10.6 million higher because of the strong demand for training.
- TS/M revenue was 17% or $8.1 million higher because of the integration of Kesem and higher revenue from our training centre in Benson, U.K.

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

EBIT[7] was $9.1 million higher than last quarter and $44.2 million higher year over year

EBIT for this quarter was $53.3 million, or 15.8% of revenue, and $52.2 million, or 15.5% of revenue excluding non-recurring items. This quarter we reversed a net provision of $1.1 million relating to the restructuring plan. You will find more details in

Reconciliation of non-recurring items.

Compared to last quarter, EBIT was up by 21% or $9.1 million. Segment operating income [8] for TS/C increased by $7.8 million but was partly offset by a decrease in the other segments. Lower activity related to the restructuring plan increased EBIT by $3.9 million. EBIT last quarter was $47.0 million, or 14.2% of revenue, excluding non-recurring items.

EBIT was up by $44.2 million over last year because of higher segment operating income in all four segments, which increased segment operating income overall by $18.0 million. EBIT was also up because restructuring activity was lower this quarter, compared to the expense of $25.1 million for the same period a year ago.

You will find more details in *Reconciliation of non-recurring items* and *Results by segment*.

Net interest expense was $0.6 million higher than last quarter and $2.6 million higher year over year

Net interest expense was 21% higher than last quarter because of slightly higher interest on long-term debt and lower capitalized interest. These were partly offset by higher interest income.

Net interest expense was higher than the same period last year because of:

- Higher interest expense on long-term debt.
- Lower interest revenue mainly because we recognized $2.2 million in revenue in the fourth quarter of fiscal 2006 from the accretion of discounts on notes receivable owed to us by the acquirer of one of our discontinued operations. This was partly offset by higher interest earned on cash on hand this quarter and higher capitalized interest because assets under construction were higher compared to the same period last year.

[7] Non-G AAP measure (see Section 3.7) .
[8] Non-G AAP measure (see Section 3.7) .

Effective income tax rate is 30% this quarter

Income taxes this quarter were $14.7 million, representing an effective tax rate of 30%, compared to 28% for the last quarter and a tax recovery of $6.4 million in the fourth quarter of fiscal 2006.

The recovery in the fourth quarter of last year was mainly attributed to the recognition of $9.0 million of tax assets from the reduction of the valuation allowance on our net operating losses in the U.S. and other recoveries. This recognition was mainly because of the further improvement in profitability of our U.S. operations.

Excluding non-recurring items, income tax expense was:

- $13.6 million for this quarter, representing an effective tax rate of 28%
- $12.1 million for the third quarter, representing an effective tax rate of 27%
- $8.7 million for the fourth quarter last year, representing an effective tax rate of 27%.

You will find more details in *Reconciliation of non-recurring items*.

Net loss from discontinued operations was $0.8 million higher this quarter and $4.6 million lower year over year

Net loss from discontinued operations this quarter was mainly because of a net loss from Forestry Systems. Consulting and legal fees that were recorded this quarter were partly offset by a net gain from property sold that was classified as assets held for sale. Compared to the same period last year, the net loss from discontinued operations was lower mainly because of our former Cleaning Technologies business for which, in fiscal 2006, we incurred significant costs that were mostly related to the revaluation of a pension liability and a reversal of an unrecognized tax asset.

4.2 RESULTS OF OUR OPERATIONS – FISCAL 2007

Summary of consolidated results

(amounts in millions, except per share amounts)		**2007**	2006	2005
Revenue	**$**	**1,250.7**	1,107.2	986.2
Gross margin [9]	**$**	**364.4**	266.2	217.6
As a % of revenue	***%***	***29.1***	*24.0*	*22.1*
Earnings (loss) before interest and income taxes (EBIT)	**$**	**189.4**	104.0	(372.9)
As a % of revenue	***%***	***15.1***	*9.4*	–
Interest expense, net	**$**	**10.6**	16.2	32.1
Earnings (loss) from continuing operations (before taxes)	**$**	**178.8**	87.8	(405.0)
Income tax expense (recovery)	**$**	**49.7**	18.2	(100.6)

Earnings (loss) from continuing operations	**$**	**129.1**	69.6	(304.4)
Results from discontinued operations	**$**	**(1.7)**	(6.0)	104.8
Net earnings (loss)	**$**	**127.4**	63.6	(199.6)
Basic and diluted EPS from continuing operations	**$**	**0.51**	0.28	(1.23)
Basic EPS	**$**	**0.51**	0.25	(0.81)
Diluted EPS	**$**	**0.50**	0.25	(0.81)

We have restated comparable periods to reflect a change in the stock-based compensation expense (EIC-162).

Summary of results excluding non-recurring items

(amounts in millions, except per share amounts)		**2007**	2006	2005
Earnings from continuing operations (before taxes)	**$**	**181.1**	122.9	65.5
Net earnings from continuing operations	**$**	**129.3**	85.5	47.2
Basic and diluted EPS from continuing operations	**$**	**0.51**	0.35	0.19

We have restated comparable periods to reflect a change in the stock-based compensation expense (EIC-162).

Revenue was 13% or $143.5 million higher than last year

The increase in revenue over last year was due to growth in all four segments, and mainly from the SP/C and SP/M segments. SP/C revenue was 35% or $91.1 million higher because of the large number of new orders and a higher number of deliveries. SP/M revenue was 9% or $30.1 million higher because of higher order intake particularly in the U.S. and the U.K.

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

Gross margin was $98.2 million higher than last year

Gross margin was $364.4 million this year or 29.1% of revenue compared to $266.2 million or 24.0% of revenue last year. The increase comes from improvement in all four segments.

[9] Non-G AAP measure (see Section 3.7) .

EBIT was $85.4 million higher than last year

EBIT was $189.4 million for the year, or 15.1% of revenue, and $193.1 million, or 15.4% of revenue excluding non-recurring items mainly related to the restructuring plan, which we completed this quarter.

EBIT was up by $85.4 million over last year because of the increase in segment operating income for all segments (almost 50% from SP/C) and a decrease this year in the costs related to the restructuring plan.

EBIT was affected by various non-recurring items in fiscal 2006 totalling $32.8 million:

- A $5.3 million net foreign exchange gain on the reduction of the investment in certain self-sustaining subsidiaries.
- A gain of $1.8 million related to exiting the Do328J platform.
- A write-down of $5.9 million of deferred bid costs (incurred post-selection) on certain projects.
- Costs relating to the restructuring plan of $34.0 million.

Excluding these non-recurring items, EBIT was $136.8 million (12.4% of revenue).

You will find more details in *Reconciliation of non-recurring items* and *Results by segment*.

Net interest expense was $5.6 million lower than last year

(amounts in millions)		**FY2006 to FY2007**	FY2005 to FY2006
Net interest, prior period	**$**	**16.2**	$ 32.1
Decrease in interest on long-term debt		**(3.1)**	(12.3)
(Increase)/decrease in interest income		**2.1**	(1.2)
(Increase)/decrease in capitalized interest		**(1.3)**	3.0
Decrease in amortization of deferred financing charges		**(1.7)**	(5.7)
Other		**(1.6)**	0.3

Decrease in net interest expense from the prior period	**$ (5.6)**	$	(15.9)
Net interest, current period	**$ 10.6**	$	16.2

Net interest expense was $10.6 million this year, which is 35% or $5.6 million lower than last year. This is mainly because of:

- Lower interest expense on overall long-term debt:
  - We repaid the Amsterdam asset-backed financing at the end of the third quarter of fiscal 2006.
  - We repaid the $20 million senior note tranche in fiscal 2006.
- Reduced amortization of deferred financing costs:
  - We had lower amortization of deferred costs from the new credit facility.
  - In fiscal 2006, we wrote off all of the unamortized deferred financing charges related to our previous revolving credit facility.
- Increased capitalized interest:
  - We had a higher level of assets under construction at the end of the year compared to last year.

Effective income tax rate is 28%

Income taxes were $49.7 million this year, representing an effective tax rate of 28%, compared to 21% for the same period last year. We recorded additional benefits of $9.0 million in the fourth quarter of fiscal 2006 because of the reduction in valuation allowance on U.S. net operating losses and other tax recoveries.

Income tax expense, excluding non-recurring items, was:

- $51.8 million this year, representing an effective tax rate of 29%.
- $37.4 million for last year, representing an effective tax rate of 30%.

We expect the effective income tax rate for fiscal 2008 to be approximately 30%. You will find more details in *Reconciliation of non-recurring items*.

Net loss from discontinued operations was $4.3 million lower than last year

Net loss from discontinued operations was $1.7 million this year, which is 72% or $4.3 million lower than last year. This is mainly because of:

- The net loss from discontinued operations that we incurred last year from our former Cleaning Technologies business.
- Interest expense related to debt not directly attributed to continuing operations. We paid this using the proceeds of the sale of the Marine Controls segment that we also recorded in fiscal 2006.

4.3 RESULTS OF OUR OPERATIONS – FISCAL 2006 VS FISCAL 2005

Revenue

Revenue grew in fiscal 2006, a significant increase of $121.0 million, or 12%, from the year before. Growth in each of the four segments was mainly because of:

- Higher FFS deliveries in the SP/C segment.
- Progress on the NH90 contract in the SP/M segment.
- An improved business environment for the TS/C segment.
- Higher levels of maintenance and support in the TS/M segment.

EBIT

EBIT was $104.0 million in fiscal 2006. This included a net foreign exchange gain on the reduction of the net investment in certain self-sustaining foreign subsidiaries, a gain on exiting the Do328J platform, a write-down related to deferred bid costs and additional restructuring charges. EBIT would have been $136.8 million before these items.

EBIT was negative $372.9 million in fiscal 2005. This included the effect of impairment and restructuring charges. If the impairment and restructuring charges, and the offsetting recognition of additional investment tax credits related to fiscal 2000 to 2004 are not included, EBIT for

fiscal 2005 was $88.4 million.

Net interest

Net interest was $15.9 million lower than fiscal 2005, mainly because:

- Borrowing activity was lower on the revolving term credit facility in fiscal 2006.
- Interest revenue was higher, mainly because in fiscal 2006 we recognized interest revenue from the accretion of discounts on notes receivable owed to us by the acquirer of a discontinued operation.
- Capitalization interest was lower in fiscal 2006 because of fewer assets under construction.
- Reduced amortization of deferred financing charges from the Brazilian financing repaid at the end of fiscal 2005.

ncome taxes

We had a net tax recovery of $100.6 million in fiscal 2005 mainly because of the large impairment charge. This was partly offset by a recognition of $23.5 million in tax assets. We recorded an income tax expense of $18.2 million in fiscal 2006.

Discontinued operations

We recorded a net loss of $6.0 million from discontinued operations in fiscal 2006 because of adjustments to pension provisions and other obligations from discontinued operations. We reported a gain of $104.8 million in fiscal 2005, which was mainly from the sale of the Marine Controls segment.

4.4 EARNINGS EXCLUDING NON-RECURRING ITEMS

The table below shows how non-recurring items have affected our results in each of the reporting periods. We believe this supplemental information is a useful indication of our performance before these non-recurring items. It is important, however, not to confuse this information with, or use it as an alternative for, net earnings calculated according to GAAP.

Reconciliation of non-recurring items – Fourth quarter of fiscal 2007

(amounts in millions, except per share amounts)

	Q4-2007			Q3-2007			Q4-2006		
	before tax	**after tax**	**per share**	before tax	after tax	per share	before tax	after tax	per share
Earnings from continuing operations	**$ 49.8**	**$ 35.1**	**0.14**	$ 41.3	$ 29.7	$ 0.12	$ 8.2	$ 14.6	$ 0.06
EBIT:									
• Restructuring plan – restructuring charge	**(1.5)**	**(1.2)**	**–**	2.3	2.0	0.01	13.8	10.3	0.04
– other costs associated with the restructuring plan	**0.4**	**1.2**	**–**	0.5	0.3	–	11.3	8.7	0.03
Interest expense, net:									
• Accretion of discounts on notes receivable	**–**	**–**	**–**	–	–	–	(1.6)	(1.6)	(0.01)
Income tax expense:									
• Tax recoveries	**–**	**–**	**–**	–	–	–	–	(9.0)	(0.03)
Earnings from continuing operations excluding non-recurring items (non-GAAP measure)	**$ 48.7**	**$ 35.1**	**0.14**	$ 44.1	$ 32.0	$ 0.13	$ 31.7	$ 23.0	$ 0.09

We restated comparable periods to reflect a change in the stock-based compensation expense (EIC-162).

Reconciliation of non-recurring items – for the 12-month period ending March 31

(amounts in millions, except per share amounts)

	Fiscal 2007			Fiscal 2006			Fiscal 2005		
	before tax	**after tax**	**per share**	before tax	after tax	per share	before tax	after tax	per share
Earnings from continuing operations	**$ 178.8**	**$ 129.1**	**$ 0.51**	$ 87.8	$ 69.6	$ 0.28	$ (405.0)	$ (304.4)	$ (1.23)
EBIT:									
• Restructuring plan – restructuring charge	**1.2**	**1.0**	**–**	18.9	14.1	0.06	24.5	16.7	0.07
– other costs associated with the restructuring plan	**6.9**	**5.5**	**0.03**	15.1	11.3	0.05	7.7	5.7	0.02
• Release of claims payment	**(4.4)**	**(3.1)**	**(0.01)**	–	–	–	–	–	–
• Foreign exchange gain	**–**	**–**	**–**	(5.3)	(5.7)	(0.02)	–	–	–
• Write-down of deferred bid costs	**–**	**–**	**–**	5.9	5.1	0.02	–	–	–
• Exit from the Dornier 328J platform	**–**	**–**	**–**	(1.8)	(1.0)	(0.01)	–	–	–
• Additional ITC recognition (FY2000-FY2004)	**–**	**–**	**–**	–	–	–	(14.2)	(10.1)	(0.04)
• Impairment charge	**–**	**–**	**–**	–	–	–	443.3	354.2	1.43
Interest expense, net:									
• Early repayment of notes receivable	**(1.4)**	**(1.4)**	**(0.01)**	–	–	–	–	–	–
• Accretion of discounts on notes receivable	**–**	**–**	**–**	(1.6)	(1.6)	(0.01)	–	–	–
• Early settlement of high-cost long-term debts	**–**	**–**	**–**	2.8	2.0	0.01	9.2	8.6	0.03
• Write-down of unamortized deferred financing costs	**–**	**–**	**–**	1.1	0.7	–	–	–	–
Income tax expense:									
• Tax recoveries	**–**	**(1.8)**	**(0.01)**	–	(9.0)	(0.03)	–	(23.5)	(0.09)
Earnings from continuing operations excluding non-recurring items (non-GAAP measure)	**$ 181.1**	**$ 129.3**	**$ 0.51**	$ 122.9	$ 85.5	$ 0.35	$ 65.5	$ 47.2	$ 0.19

We have restated comparable periods to reflect a change in the stock-based compensation expense (EIC-162).

Restructuring plan

We had a net reversal of $1.1 million this quarter, which resulted in an expense of $8.1 million for the year. The reversal relates to a provision that was set up in fiscal 2006 to cover the eventual severance cost for TS/C. We estimated the provision on the probable cost of terminating certain employees based on the different scenarios. The actual severance costs were lower following option by these employees. This reversal was partly offset by costs incurred to relocate the remaining simulators and to implement our ERP system. We completed the relocation of 15 FFSs this year. This leaves one to be relocated in fiscal 2008, the costs of which will be absorbed in our continuing operations results. In order to better serve our client, we consolidated our training services and, as a consequence, we closed three training centres this year: in Alcala, Spain, the Maastricht flight school in the Netherlands and the facility in Dallas in the U.S.

Early repayment of notes receivable

In the second quarter of fiscal 2007, we received an early payment, in full, of secured, subordinated promissory long-term notes receivable that we had recorded in other assets. The amount was part of the consideration for our sale of Ultrasonics and Ransohoff in 2002. We recognized $1.4 million in interest revenue in the second quarter as a result of the repayment, because of the accretion of discounts on the long-term notes receivable.

Licence and release of claims payment – Landmark Consortium

As a member of the Landmark Consortium (formed to pursue the AVTS project), we licensed the use of our intellectual property in relation to the AVTS project to the U.K. Ministry of Defence (the Authority) in the first quarter of fiscal 2007. The contract also releases all Landmark Consortium members of all claims and potential claims they might make against the Authority relating to the change in the approach to procurement for the AVTS program. Our share of the contract is valued at £4.2 million ($8.8 million). We received the payment in the first quarter and recorded £2.1 million ($4.4 million) as a non-recurring item because it was related to the release of claims. We recorded the remaining £2.1 million ($4.4 million), which related to a licence of intellectual property, in the corresponding military segments.

Accretion of discount on notes receivable

In the fourth quarter of fiscal 2006, we had $2.2 million in additional interest from the accretion of discount on notes receivable. Only $0.6 million of this amount was considered recurring each year until maturity.

Early settlement of high-cost, long-term debts

In the third quarter of fiscal 2006, we took advantage of available liquidity and the strong Canadian dollar to prepay a higher cost, asset-backed financing arrangement that was in place when we acquired Schreiner Aviation Training. The Amsterdam asset-backed financing was €22.7 million, and the prepayment resulted in a one-time, pre-tax charge totalling $2.8 million.

Write-down of unamortized deferred financing costs

We closed the new credit facility on July 7, 2005 and wrote down unamortized deferred financing costs of $1.1 million in the second quarter of fiscal 2006. These costs were related to the original credit facility that had been in place.

Foreign exchange gain

We reduced our net investment in certain self-sustaining subsidiaries in fiscal 2006, and transferred corresponding amounts of foreign exchange gain or losses accumulated in the currency translation adjustment C TA) account to the statement of earnings. This resulted in a non-recurring pre-tax gain of $5.3 million. The reduction of capitalization in self-sustaining subsidiaries is not part of our day-to-day operations and we do not consider any impact on the results to be recurring.

Write-down of deferred bid costs

In the first quarter of fiscal 2006, we wrote down deferred bid costs (incurred post selection) amounting to $5.9 million accumulated on major military programs for which, we were selected and for which subsequent to selection, the likelihood of success was significantly reduced. Of the $5.9 million, $4.4 million was related to the AVTS program.

Exit from the Dornier 328J platform

In the third quarter of fiscal 2006, we reached a decision to no longer offer training services for the Dornier 328 Jet (Do328J) aircraft. We sold two Do328J FFSs that quarter, for a net gain of $1.8 million.

Additional ITCs recognition (fiscal 2000 to 2004)

While ITCs are a normal part of our business, in fiscal 2005 we recognized additional ITCs of $14.2 million, increasing SP/C operating income by $9.8 million in the first quarter of fiscal 2005, and SP/M operating income that quarter by $4.4 million. The additional credits were from a change we made to our estimate of ITCs recoverable in fiscal 2003 and 2004, based on an audit by tax authorities of R&D expenditures we claimed from fiscal 2000 to 2002.

Tax recoveries

We consider the following tax recoveries to be non-recurring because they were not part of our day-to-day operations:

- We reduced the valuation allowance on net operating losses in the U.K. this year, which allowed us to recognize a cumulative $1.8 million in tax assets (net of a $0.2 million reversal in the second quarter).
- We recorded additional benefits of $9.0 million in the fourth quarter of fiscal 2006 because of the reduction in valuation allowances on U.S. net operating losses and other tax recoveries.
- We recognized $23.5 million in tax assets as non-recurring items in fiscal 2005. This was from a reduction in the valuation allowance for net operating losses, and for capital losses for income tax purposes in the U.S.

Impairment charge

In the third quarter of fiscal 2005, we began a comprehensive review of the performance and strategic orientation of our business units. This revealed several factors that had a significant impact mainly on the civil segment (which we now operate as the SP/C and TS/C segments). We recorded an impairment charge of $443.3 million as at December 31, 2004. You can find more details in our consolidated financial statements for fiscal 2005.

4.5 GOVERNMENT COST-SHARING

We continue to invest in new and innovative technologies to respond to growth opportunities and to maintain our technological leadership.

During fiscal 2006, we launched Project Phoenix, a $630-million, six-year R&D initiative to improve leading-edge technologies and to develop additional applications that reinforce our industry position as a world leader in simulation, modelling and services. The Government of Canada agreed, through Technology Partnerships Canada (TPC), to invest up to 30% ($189 million) of the value of the program. We also signed an agreement this year with the Government of Québec for Investissement Québec to contribute $31.5 million to Project Phoenix over six years. We recognize a liability to repay these contributions when conditions arise. The repayment is reflected in the consolidated statements of earnings when royalties become due.

This year, the two governments contributed a total of $52.1 million to Project Phoenix. We recorded $45.0 million as a reduction of R&D expenses and $7.1 million for fixed assets or other capitalized costs. We recognized the contribution relating to the agreement with the Government of

Québec based on costs incurred since June 2005.

We have also been involved in various other TPC projects on R&D programs in the past few years that involve visual systems and advanced flight simulation technology for civil applications and networked simulation for military applications. We recorded royalty expenses of $7.5 million for these TPC projects this year.

The table below lists the contribution and royalties for all programs:

(amounts in millions)	**2007**	2006	2005
Contribution:			
Phoenix	**$ 52.1**	$ 17.3	$ –
Previous programs	**–**	7.5	10.8
Total contribution	**$ 52.1**	$ 24.8	$ 10.8
Amount capitalized	**(7.1)**	(3.8)	(0.9)
Amounts credited to income	**$ 45.0**	$ 21.0	$ 9.9
Royalty expense	**(7.5)**	(6.6)	(5.9)
Impact of contribution on earnings [(1)]	**$ 37.5**	$ 14.4	$ 4.0
Approximate impact of contribution on ITCs (25%)	**(9.4)**	(3.6)	(1.0)
Approximate pre-tax impact of contribution to various R&D programs	**$ 28.1**	$ 10.8	$ 3.0

[(1)] We estimate that every $100 of net contribution we receive under various programs reduces the amount of ITCs by approximately$25 to $30 that would otherwise be available.

The above table does not reflect the additional R&D expenses that we incurred to secure the TPC funding. We must spend approximately $100 of eligible costs in order to receive approximately $30 in contribution.

4.6 CONSOLIDATED ORDERS AND BACKLOG

Our consolidated backlog was $2,774.6 million at the end of this year, which is 13% higher than last year. New orders of $1,455.2 million were added to backlog this year, offset by $1,250.7 million in revenue generated from backlog and an increase of $110.1 million mainly from the decrease in value of the Canadian dollar against the euro and the British pound.

Change in backlog

As at March 31, (amounts in millions)	**2007**	2006	2005
Backlog, beginning of period	**$ 2,460.0**	$ 2,504.7	$ 2,292.4
+ orders	**1,455.2**	1,238.7	1,342.6
– revenue	**(1,250.7)**	(1,107.2)	(986.2)
+/– adjustments (mainly FX)	**110.1**	(176.2)	(144.1)
Backlog, end of period	**$ 2,774.6**	$ 2,460.0	$ 2,504.7

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

5. RESULTS BY SEGMENT

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

Civil segments:

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

Military segments:

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

The SP/C and SP/M segments operate as an integrated organization that shares substantially all engineering, development, global procurement, program management and manufacturing functions.

Transactions between segments are mainly transfers of simulators from SP/C to TS/C and are recorded at cost at the consolidated level. If we can measure a segment's use of jointly used assets, costs and liabilities (mostly corporate costs), we allocate them to the segment in that proportion. If we cannot measure a segment's use, we allocate in proportion to the segment's cost of sales.

KEY PERFORMANCE INDICATORS

Segment operating income

(amounts in millions, except operating margins)		**FY2007**	FY2006	**Q4-2007**	Q3-2007	Q2-2007	Q1-2007	Q4-2006
Civil segments								
Simulation Products/Civil	**$**	**60.4**	29.9	**15.3**	15.5	18.7	10.9	9.3
	%	***17.4***	*11.6*	***15.7***	*16.8*	*22.2*	*14.7*	*11.9*
Training & Services/Civil	**$**	**64.3**	57.1	**21.3**	13.5	11.2	18.3	14.9
	%	***19.1***	*17.7*	***23.2***	*16.2*	*14.3*	*21.9*	*18.4*
Military segments								
Simulation Products/Military	**$**	**39.1**	27.0	**9.5**	11.2	7.3	11.1	6.8
	%	***10.9***	*8.2*	***10.3***	*10.6*	*11.4*	*11.6*	*8.8*
Training & Services/Military	**$**	**33.7**	18.7	**6.1**	6.8	9.3	11.5	3.2
	%	***16.2***	*9.3*	***10.9***	*13.4*	*17.4*	*23.9*	*6.7*
Total segment operating income	**$**	**197.5**	132.7	**52.2**	47.0	46.5	51.8	34.2
Other (expense) income expenses	**$**	**(8.1)**	(28.7)	**1.1**	(2.8)	(1.7)	(4.7)	(25.1)
EBIT	**$**	**189.4**	104.0	**53.3**	44.2	44.8	47.1	9.1

We have restated comparable periods to reflect a change in the stock-based compensation expense (EIC-162).

We use segment operating income to measure the profitability of our four operating segments, and to help us make decisions about allocating resources. We calculate segment operating income by using a segment's net earnings before other income, interest, income taxes and discontinued operations. This allows us to assess the profitability of a segment before the impact of things not specifically related to its performance.

Capital employed

(amounts in millions)		**March 31 2007**	December 31 2006	September 30 2006	June 30 2006	March 31 2006
Civil segments						
Simulation Products/Civil	**$**	**(59.8)**	(3.0)	(13.6)	(19.0)	(37.7)
Training & Services/Civil	**$**	**759.1**	714.8	639.6	618.7	614.9
Military segments						
Simulation Products/Military	**$**	**54.5**	34.7	57.7	48.0	49.3
Training & Services/Military	**$**	**132.8**	136.6	129.2	119.2	111.5
	$	**886.6**	883.1	812.9	766.9	738.0

We use capital employed to understand how much we are investing in our business. We calculate it by taking each segment's total assets (not including cash and cash equivalents, tax accounts and other non-operating assets), and subtracting total liabilities (not including tax accounts, long-term debt and its current portion, and other non-operating liabilities).

5.1 CIVIL SEGMENTS

SIMULATION PRODUCTS/CIVIL

SP/C was awarded the following FFS contracts this quarter:

- One A320 FFS-5200 to Lufthansa
- One A330/340 FFS to Air China
- One B737 FFS to KLM
- One B737 FFS to Air China
- One B787 FFS to China Eastern
- Two B787 FFSs to Qantas.

Order intake this quarter was seven FFSs, bringing SP/C's total order intake for the year to 34 FFSs.

Financial results

(amounts in millions, except operating margins)		**FY2007**	FY2006	**Q4-2007**	Q3-2007	Q2-2007	Q1-2007	Q4-2006
Revenue	**$**	**348.1**	257.0	**97.6**	92.1	84.2	74.2	78.0
Segment operating income	**$**	**60.4**	29.9	**15.3**	15.5	18.7	10.9	9.3
Operating margins	*%*	***17.4***	*11.6*	***15.7***	*16.8*	*22.2*	*14.7*	*11.9*
Amortization & depreciation	**$**	**9.4**	11.3	**2.9**	2.3	2.1	2.1	2.2
Capital expenditures	**$**	**14.4**	5.7	**1.8**	0.9	3.5	8.2	2.5
Capital employed	**$**	**(59.8)**	(37.7)	**(59.8)**	(3.0)	(13.6)	(19.0)	(37.7)
Backlog	**$**	**352.8**	284.4	**352.8**	340.0	313.2	297.5	284.4

We have restated comparable periods to reflect a change in the stock-based compensation expense (EIC-162).

Revenue up by 6% from last quarter and by 25% year over year

Revenue increased over last quarter and last year because of the higher number of recent orders and because we achieved some important milestones on several projects.

Revenue was $348.1 million for the year, which is 35% or $91.1 million higher than last year

The increase reflects stronger order intake and a higher number of deliveries this year (25 deliveries this year compared to 18 in fiscal 2006).

Segment operating income similar to last quarter and up by 65% year over year

Segment operating income was similar to last quarter despite an increase in revenue. Operating margins are down from last quarter mainly because:

- We intensified our development efforts on our new CAE 5000 Series simulator, which we recently launched.
- We wrote down some deferred licence costs that we re-negotiated with one of our suppliers to give us more flexibility.

SP/C's segment operating income was higher than last year because revenue was higher, we improved productivity and we started recognizing Investissement Québec's contribution to Project Phoenix this fiscal year.

Segment operating income was $60.4 million for the year, which is 102% or $30.5 million higher than last year

The increase reflects higher revenue, improved program execution and higher contributions to Project Phoenix from Technology Partnership Canada and Investissement Québec.

Capital employed decreased over last quarter and over last year

Capital employed was lower mainly because of lower working capital accounts. This was because we collected a large number of milestone-based receivables this quarter.

Backlog up by 24% over last year

(amounts in millions)		**FY2007**		FY2006
Backlog, beginning of period	**$**	**284.4**	$	273.5
+ orders		**406.9**		284.4
– revenue		**(348.1)**		(257.0)
+/– adjustments (mainly FX)		**9.6**		(16.5)
Backlog, end of period	**$**	**352.8**	$	284.4

This year's book-to-sale ratio is 1.2x.

TRAINING & SERVICES/CIVIL

TS/C was awarded over $140 million in contracts this quarter.

Expansion and new initiatives

- In fiscal 2007, we opened one new training centre, expanded two and announced plans for an additional one:
  - The six-bay North East Training Centre near the Morristown, New Jersey airport officially started training in January 2007.
  - The four-bay expansion at the Burgess Hill Training Centre also officially opened in January 2007.
  - The new four-bay wing of the CAE Aviation Training Centre near Barajas Airport in Spain officially opened in March 2007.
  - We announced our intention to open our first Indian flight training centre in Bangalore in fiscal 2008.
- We pushed forward with our strategy to sell more *wet training* (total services training) and launched our pilot provisioning strategy.

- We received Level D certification on the second Dassault 900EX EASy / 2000EX EASy FFS and started the maintenance training program on the Dassault Falcon 7X. We received Interim Level C qualification on the world's first Dassault 7X FFS on April 20, 2007.
- Dassault approved our Falcon 2000EX EASy maintenance training course, and certified the course according to the Dassault Falcon Training Policy Manual (FTPM). We are to provide training to instructors according to the standards in the FTPM.
- We also:
  - Added three new flight training organizations to the CAE Global Academy, bringing the number of schools in the network to six and increasing the supply of pilots who will graduate annually and be licensed from over 600 to over 1,000.
  - Signed agreements with Ryanair and Interglobe Aviation Limited (IndiGo) to train a total of 1,490 pilots over the next four years for possible employment with them.
  - Continue to see the benefits of our wet services and pilot supply initiatives as our revenue mix shifts. This strategy also allows us to expand our product offering and enhance our value proposition to customers.
  - Launched Emirates-CAE Flight Training, the first-ever Gulfstream 550 business jet training program in the Persian Gulf region, and welcomed the first customers.
- We launched the Innovation Group, an initiative aimed at identifying opportunities for us to leverage our expertise and leading- edge simulation technologies in adjacent markets.

Financial results

(amounts in millions, except operating margins, RSEU and FFSs deployed)		**FY2007**	FY2006	**Q4-2007**	Q3-2007	Q2-2007	Q1-2007	Q4-2006
Revenue	**$**	**336.9**	322.3	**91.7**	83.1	78.4	83.7	81.1
Segment operating income	**$**	**64.3**	57.1	**21.3**	13.5	11.2	18.3	14.9
Operating margins	***%***	***19.1***	*17.7*	***23.2***	*16.2*	*14.3*	*21.9*	*18.4*
Amortization & depreciation	**$**	**45.5**	43.3	**12.4**	11.8	10.7	10.6	10.7
Capital expenditures	**$**	**108.1**	87.5	**27.7**	32.5	30.1	17.8	21.3
Capital employed	**$**	**759.1**	614.9	**759.1**	714.8	639.6	618.7	614.9
Backlog	**$**	**951.6**	809.0	**951.6**	905.6	842.9	817.6	809.0
RSEU [10]		**99**	98	**101**	97	99	98	95
FFSs deployed		**114**	108	**114**	110	110	110	108

We have restated comparable periods to reflect a change in the stock-based compensation expense (EIC-162).

Revenue was $91.7 million this quarter, up 10% over last quarter

The 10% increase from last quarter is attributed to a strong demand in most of our training centres and an increase of four units in RSEUs. The decrease in value in the quarter of the Canadian dollar against the euro, British pound and the U.S. dollar also made a small contribution.

Revenue was $336.9 million this year, which is 5% higher than last year

This growth in revenue is mainly because of the strong demand for training, which reflects the healthy state of the aerospace industry, and because of the average increase of one RSEU. This is despite the 5% increase in value of the Canadian dollar against the U.S. dollar during the year.

Segment operating income was $21.3 million (23.2% of revenue)

Segment operating income was higher this quarter because of a gain of $1.1 million from the disposal of one used FFS and a net gain of $1.3 million following the negotiation of various agreements with a business partner. Segment operating income would otherwise have been $18.9 million (20.6% of revenue), 40% or $5.4 million higher than last quarter, and 27% or $4.0 million higher than the same period last year.

Segment operating income grew by 13% over last year, to $64.3 million

The increase was due to the higher activity level and improved operational efficiencies. This is despite a 5% increase in value of the Canadian dollar against the U.S. dollar and minimal change in our average number of RSEUs over last year.

Capital employed increased over last year

Capital employed was higher mainly because of the formalization of the ECFT joint venture, an increase in working capital tied to revenue growth, an increase in capital spending on various investments that exceeded our amortization and depreciation expenses for the quarter, an increase in our working capital and the impact of foreign exchange.

[10] Non-GAAP measure (see Section 3.7) .

Capital expenditures at $27.7 million this quarter and $108.1 million for the year

Capital expenditures were higher this year mainly because of the ongoing investment in the Dassault Falcon 7X training program, our expansion and conversion of the Burgess Hill (U.K.) and Madrid training centres, and new simulators being added to our network.

Backlog up by 18% over last year

(amounts in millions)		**FY2007**	FY2006
Backlog, beginning of period	**$**	**809.0**	$ 829.6
+ orders		**452.5**	346.9
– revenue		**(336.9)**	(322.3)
+/– adjustments (mainly FX)		**27.0**	(45.2)
Backlog, end of period	**$**	**951.6**	$ 809.0

This year's book-to-sale ratio was 1.3x.

5.2 MILITARY SEGMENTS

SIMULATION PRODUCTS/MILITARY

SP/M was awarded $118.5 million in orders this quarter, including:

- One EH101 Full Crew Mission Simulator (FCMS) for the Italian Navy.
- One NH90 virtual maintenance trainer (VMT) for the German Air Force.
- Design and development of various upgrades for the United States Special Operations' MH-47 and MH-60 full mission simulators (FMS) under the ASTARS program.
- The design and development of an upgrade to the British Navy's CAE-built Lynx MK8 full mission simulator.
- One Lynx crew procedures trainer (LCPT) for the U.K. Royal Navy.
- An upgrade to the British Army's Artillery Fire Control Trainers.
- Design and development of two EC 135 flight training devices (FTDs) for the Eurocopter training center in Germany and the United States.

Financial results

(amounts in millions, except operating margins)		**FY2007**	FY2006	**Q4-2007**	Q3-2007	Q2-2007	Q1-2007	Q4-2006
Revenue	**$**	**357.5**	327.4	**92.2**	105.2	64.3	95.8	77.5
Segment operating income	**$**	**39.1**	27.0	**9.5**	11.2	7.3	11.1	6.8
Operating margins	***%***	***10.9***	*8.2*	***10.3***	*10.6*	*11.4*	*11.6*	*8.8*
Amortization & depreciation	**$**	**9.0**	13.8	**2.6**	1.9	2.3	2.2	5.9
Capital expenditures	**$**	**5.5**	6.0	**1.8**	1.5	0.9	1.3	3.0
Capital employed	**$**	**54.5**	49.3	**54.5**	34.7	57.7	48.0	49.3
Backlog	**$**	**635.8**	540.5	**635.8**	609.0	626.3	475.2	540.5

We have restated comparable periods to reflect a change in the stock-based compensation expense (EIC-162).

Revenue down by 12% over last quarter and up by 19% year over year

The decrease over last quarter was mainly due to an unusually high level of activity on some European programs last quarter, particularly the Eurofighter program. This was partly offset by increased activity on some U.S. programs and the decrease in value of the Canadian dollar against the U.S. dollar, the euro and the British pound during the quarter.

The increase over last year was mainly due to higher activity on some U.S. programs and the decrease in value during the period of the Canadian dollar against the U.S. dollar, the euro and the British pound.

Revenue was $357.5 million this year, which is 9% or $30.1 million higher than last year

The increase reflects the higher level of order intake, particularly in the United States and the United Kingdom. This was partly offset by an increase in value of the Canadian dollar against the U.S. dollar.

Segment operating income down by 15% over last quarter and up by 40% year over year

The decrease over last quarter was mainly because we wrote down some deferred licence costs that we re-negotiated with one of our suppliers to give us more flexibility.

SP/M's segment operating income was higher than last year because revenue was higher as explained above, and because we started recognizing Investissement Québec's contribution to Project Phoenix this fiscal year.

Segment operating income was $39.1 million this year, which is 45% or $12.1 million higher than last year

This was mainly because of the increase in revenue as explained above, combined with lower amortization expense from the write-down last year of some deferred development costs.

Capital employed increased over last quarter

The increase this quarter was mainly because of higher working capital accounts.

Backlog up by 18% over last year

(amounts in millions)		**FY2007**	FY2006
Backlog, beginning of period	**$**	**540.5**	$ 511.3
+ orders		**421.3**	364.4
– revenue		**(357.5)**	(327.4)
+/– adjustments (mainly FX)		**31.5**	(7.8)
Backlog, end of period	**$**	**635.8**	$ 540.5

This year's book-to-sale ratio is 1.2x.

TRAINING & SERVICES/MILITARY

TS/M was awarded the following major contracts this quarter:

- Engineering support services on the U.S. Marine Corp's AV-8B and KC-130 training devices in Cherry Point, North Carolina and Yuma, Arizona.
- Professional engineering and project management services to Canada's Department of National Defence (DND) under the Technical Investigation and Engineering Services (TIES) program.
- Renewal of a range of support services for all German Armed Forces' flight simulators, including Eurofighter, Tornado and P-3C Orion training devices, as well as helicopter simulators located at the German Army Aviation School at Bueckeburg.

Financial results

(amounts in millions, except operating margins)		**FY2007**	FY2006	**Q4-2007**	Q3-2007	Q2-2007	Q1-2007	Q4-2006
Revenue	**$**	**208.2**	200.5	**55.8**	50.8	53.5	48.1	47.7
Segment operating income	**$**	**33.7**	18.7	**6.1**	6.8	9.3	11.5	3.2
Operating margins	***%***	***16.2***	*9.3*	***10.9***	*13.4*	*17.4*	*23.9*	*6.7*
Amortization & depreciation	**$**	**6.9**	7.0	**1.9**	1.7	1.8	1.5	1.6
Capital expenditures	**$**	**30.1**	30.9	**2.5**	7.8	6.4	13.4	15.5
Capital employed	**$**	**132.8**	111.5	**132.8**	136.6	129.2	119.2	111.5

Backlog	**$**	**834.4**	826.1	**834.4**	857.3	801.6	842.9	826.1

Comparable periods have been restated to reflect a change in the stock-based compensation expense (EIC-162).

Revenue up by 10% over last quarter and by 17% year over year

Revenue improved this quarter because:

- We started consolidating the results of Kesem, a professional services company acquired on December 22, 2006.
- We increased our revenue at our Medium Support Helicopter (MSH) training centre in Benson, U.K. and at our C-130 training centre in Tampa, U.S.
- The Canadian dollar decreased in value against the U.S. dollar, the euro and the British pound.

Revenue was $208.2 million this year, which is 4% or $7.7 million higher than last year

The increase is mainly due to higher activities on U.S. and German support services contracts and the integration of Kesem, which were partly offset by the increase in value of the Canadian dollar against the U.S. dollar.

Segment operating income down by 10% over last quarter and up by 91% year over year

Segment operating income decreased from last quarter despite an increase in revenue, mainly because we received a dividend last quarter from a TS/M investment in the U.K. Segment operating income would have been stable from last quarter if the impact of the dividend was not included.

The increase over last year was mainly because of higher revenue as explained above, combined with higher contributions from TPC and because we started recognizing Investissement Québec's contribution to project Phoenix in this fiscal year.

Segment operating income was $33.7 million this year, which is 80% or $15.0 million higher than last year

This was mainly due to:

- Higher revenue.
- Reception of non-recurring payment for the release of claims from the U.K. government related to the AVTS project. Last year we wrote down deferred bid costs related to the same program.
- Higher contributions from Technology Partnership Canada (TPC) and Investissement Québec to Project Phoenix.

Capital employed decreased over last quarter

The decrease this quarter was mainly because of lower working capital accounts.

Backlog stable over last year

(amounts in millions)		**FY2007**		FY2006
Backlog, beginning of period	**$**	**826.1**	$	890.3
+ orders		**174.5**		243.0
– revenue		**(208.2)**		(200.5)
+/– adjustments (mainly FX)		**42.0**		(106.7)
Backlog, end of period	**$**	**834.4**	$	826.1

This year's book-to-sale ratio is 0.8x.

Combined military book-to-sale ratio for the year was 1.1x.

6. CONSOLIDATED CASH MOVEMENTS AND LIQUIDITY

We actively manage liquidity and regularly monitor the factors that could affect it, including:

- Cash generated from operations, including timing of milestone payments and management of working capital.
- Capital expenditure requirements.
- Scheduled repayments of long-term debt obligations, our credit capacity and expected future debt market conditions.

6.1 CONSOLIDATED CASH MOVEMENTS

(amounts in millions)		**2007**		2006		2005
Cash provided by continuing operating activities*	**$**	**219.1**	$	146.8	$	95.2
Changes in non-cash working capital		**20.2**		79.1		84.2
Net cash provided by continuing operations	**$**	**239.3**	$	225.9	$	179.4
Capital expenditures		**(158.1)**		(130.1)		(118.0)
Other capitalized costs		**(11.8)**		(12.4)		(7.4)
Proceeds from sale and leaseback of assets		**–**		–		43.8
Cash dividends		**(9.8)**		(9.7)		(24.0)
Non-recourse financing[11]		**34.0**		26.5		–
Free cash flow	**$**	**93.6**	$	100.2	$	73.8
Other cash movements, net		**3.5**		12.0		(89.5)
Proceeds from disposal of discontinued operations		**(3.8)**		–		239.4
Non-recourse financing		**(34.0)**		(26.5)		–
Effect of foreign exchange rate changes on cash and cash equivalents		**4.4**		(7.6)		(2.3)
Net increase in cash before proceeds and repayment of long-term debt	**$**	**63.7**	$	78.1	$	221.4

*before changes in non-cash working capital

Free cash flow was $93.6 million this year, slightly below last year

- The increase in capital expenditures was offset by an increase in net cash from continuing operations and by the increase in non-recourse financing.

Capital expenditures and other capitalized costs increased by $27.4 million this year

Growth capital expenditures[12] of $118.9 million this year were for:

- The ongoing investment in the Dassault Falcon 7X program.
- An increase in capital spending related to the German NH90 helicopter program.
- Other capital expenditures related to growth.

Maintenance capital expenditures[13] were $39.2 million this year.

We received $34.0 million in non-recourse financing this year related to the NH90 program and a TS/C joint venture in China. Last year, we received $26.5 million for the same programs.

[11] Non-GAAP measure (see Section 3.7) .
[12] Non-GAAP measure (see Section 3.7) .
[13] Non-GAAP measure (see Section 3.7) .

6.2 SOURCES OF LIQUIDITY

We have committed lines of credit at floating rates, each provided by a syndicate of lenders. We and some of our subsidiaries can borrow funds directly from these credit facilities to cover operating and general corporate expenses and to issue letters of credit and bank guarantees.

The total amount available through these committed bank lines as at March 31, 2007 was $615.3 million, of which $139.7 million (or 23%) was used for letters of credit. The total amount available at March 31, 2006, was $608.5 million, of which $125.2 million (or 21%) was used. The slightly higher use this year is because we issued additional letters of credit and bank guarantees. There were no borrowings under the facilities as at March 31, 2007, or at March 31, 2006.

We also have the ability to borrow in various currencies through non-committed operating lines of $4.6 million. We had not drawn down on these operating lines as at March 31, 2007.

Long-term debt was $283.2 million as at March 31, 2007, compared to $271.3 million at the end of the previous fiscal year. The short-term portion of the long-term debt was $27.2 million at March 31, 2007, compared to $10.4 million at the end of the previous fiscal year. The short-term portion was higher mainly because we incurred additional debt with a 12-month maturity this quarter. The main variations in debt over the year (other than normal contractual amortization of existing debt) are described below.

We decided this quarter to use our strong cash position to prepay the senior notes tranche that was to mature in June 2007. This reduction in debt was offset somewhat by the additional non-recourse financing we raised this quarter for the German NH90 project and the Zhuhai Training Centre.

We raised $19.1 million for our 25% share of the initial drawdown on the debt facility for the German NH90 project. The project Company has a €175.5 million in non-recourse financing to finance the build-out of the project. Following the build-out period, the debt will be non-recourse to CAE and has a final maturity of June 2021.

We also raised $13.9 million to finance the acquisition of two FFSs for the Zhuhai Training Centre and to repay a short-term loan that matured in March 2007. This additional financing represented our 49% share of the term debt for the joint venture. The debts are non-recourse to CAE and have final maturities of March 2008 and December 2009.

We have an unsecured facility in place for $35.0 million to finance the cost of the ERP system. We can draw down on this facility on a quarterly basis with monthly repayments over a term of seven years beginning at the end of the first month following each quarterly disbursement. We have borrowed $9.5 million to date for costs incurred to date to implement the new system.

We have an unsecured EDC Performance Security Guarantee (PSG) account for $115.3 million (US$100 million). This is an uncommitted revolving facility for performance bonds, advance payment guarantees or similar instruments. As of March 31, 2007, we had drawn $65.6 million. This is higher than the $26.0 million as of March 31, 2006, because the volume of simulator sales was higher this year.

6.3 CONTRACTUAL OBLIGATIONS

We enter into contractual obligations and commercial commitments in the normal course of our business. These include debentures and notes and others. The table below shows you when they mature.

Contractual obligations

As at March 31, 2007 *(amounts in millions)*	2008	2009	2010	2011	2012	Thereafter	Total
Long-term debt	$ 25.3	$ 14.2	$ 94.6	$ 16.0	$ 9.8	$ 112.2	$ 272.1
Capital lease	1.9	0.8	0.8	7.6	–	–	11.1
Operating leases	73.0	74.3	57.5	57.8	60.4	225.3	548.3
Purchase obligations	27.2	9.8	–	–	–	–	37.0
Other long-term obligations	7.9	3.9	2.0	1.8	1.8	2.9	20.3
Total	**$ 135.3**	**$ 103.0**	**$ 154.9**	**$ 83.2**	**$ 72.0**	**$ 340.4**	**$ 888.8**

We also had total committed credit facilities of $475.6 million available as at March 31, 2007, compared to $483.3 million at March 31, 2006. The slight decrease in available credit was because we used it to issue bank guarantees.

We have purchase obligations related to agreements that are enforceable and legally binding. Most are agreements with subcontractors to provide services for long-term contracts that we have with our clients. The terms of the agreements are significant because they set out obligations to buy goods or services in fixed or minimum amounts, at fixed, minimum or variable prices and at approximate times. Our other long-term obligations include $14.5 million in repayments under various government assistance programs.

As at March 31, 2007, we had other long-term liabilities that are not included in the table above. These include some accrued pension liabilities, deferred revenue, gains on assets and various other long-term liabilities. Cash obligations on accrued employee pension liability depend on various elements including market returns, actuarial gains and losses and the interest rate.

We did not include future income tax liabilities since future payments of income taxes depend on the amount of taxable earnings and on whether there are tax loss carry-forwards available.

7. CONSOLIDATED FINANCIAL POSITION

7.1 CONSOLIDATED CAPITAL EMPLOYED

(amounts in millions)	**As at March 31 2007**	As at March 31 2006
Use of capital:		
Non-cash working capital	**$ (118.1)**	$ (74.5)
Property, plant and equipment, net	**986.6**	832.1
Other long-term assets	**343.9**	336.9
Net assets held for sale (current and long-term)	**–**	5.9
Other long-term liabilities	**(249.5)**	(238.0)
Total capital employed	**$ 962.9**	$ 862.4

Source of capital:		
Net debt	**$ 133.0**	$ 190.2
Shareholders' equity	**829.9**	672.2
Source of capital	**$ 962.9**	$ 862.4

We have restated comparable periods to reflect a change in the stock-based compensation expense (EIC-162).

Capital employed increased 12%

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

Non-cash working capital decreased by $43.6 million

The decrease was mainly because of a reduction in the income taxes recoverable account which is driven by a reduction of unused federal income taxes credit applied to offset the current year tax expense and by various tax reimbursements from Québec and other foreign jurisdictions.

Net property, plant and equipment up $154.5 million

The increase was from new capital expenditures of $158.1 million and $34.6 million of foreign exchange, partly offset by normal depreciation of $55.0 million.

Net debt lower than at the beginning of the year

This was mainly because of a $63.7 million net increase in cash, before proceeds and repayment of long-term debt. The amount was reduced by the depreciation of the Canadian dollar against our foreign denominated debt.

Change in net debt

(amounts in millions)	**As at March 31 2007**	As at March 31 2006
Net debt, beginning of period	**$ 190.2**	$ 285.8
Impact of cash movements on net debt (see table in the cash movements section)	**(63.7)**	(78.1)
Effect of foreign exchange rate changes on long-term debt	**6.5**	(17.5)
Decrease in net debt during the period	**(57.2)**	(95.6)
Net debt, end of period	**$ 133.0**	$ 190.2

Shareholders' equity

The $157.7 million increase in equity was mainly because of higher net earnings ($127.4 million), the proceeds from the share issue and contributed surplus ($12.8 million) and the positive change in the currency translation adjustment account ($27.5 million), which was a result of the decrease in the value of the Canadian dollar. This was after accounting for dividends ($10.0 million).

Outstanding share data

Our articles of incorporation authorize the issue of an unlimited number of common shares, and an unlimited number of preferred shares issued in series. We had a total of 251,960,449 common shares issued and outstanding as at March 31, 2007, with total share capital of $401.7 million. We also had 5,441,915 options outstanding, of which 2,986,135 were exercisable. We have not issued any preferred shares to date.

As at April 30, 2007, we had a total of 252,089,796 common shares issued and outstanding.

Dividend policy

We paid a dividend of $0.01 per share each quarter in fiscal 2007. These dividends were eligible under the Income Tax Act (*Canada*) and its provincial equivalents.

Our Board of Directors has the discretion to set the amount and timing of any dividend. The Board reviews the dividend policy once a year based on the cash requirements of our operating activities, liquidity requirements and projected financial position. We expect to pay annual dividends of approximately $10 million based on our current dividend policy and the 252.0 million common shares outstanding as at March 31, 2007.

Guarantees

We issued letters of credit and performance guarantees for $149.1 million in the normal course of business this year, compared to $98.6 million last fiscal year. The amount was higher this year mainly because of additional project-related requirements.

Non-recourse project financing

We arranged project financing for the Medium Support Helicopter (MSH) program in 1997 after entering the program with the U.K. Ministry of Defence. The contract was awarded to a consortium, CAE Aircrew Training Services Plc (Aircrew). The capital value of the assets supplied by Aircrew is over $200 million.

We have a 14% interest in CVS Leasing Ltd., which owns the simulators operated by the training centre. We manufactured and sold the FFSs to CVS Leasing Ltd., which then leased them to Aircrew for the full term of the MSH contract. Because we have a majority interest in Aircrew, we have consolidated their financial statements in our results. Future minimum lease payments associated with the FFSs leased to Aircrew are approximately $136 million as at March 31, 2007, and are included in this section in the discussion of operating leases as contractual obligations. The amount is also disclosed in Note 21 to the consolidated financial statements.

In April 2005, Helicopter Flight Training Services GmbH (HFTS), an industrial consortium we have a 25% ownership in, contracted a project-financing facility of €175.5 million to fund the acquisition of assets needed to fulfill a 14.5 year training services contract on the NH90 helicopter platform for the German Armed Forces. We account for 25% of the outstanding project-financing debt using the proportionate consolidation method. This was $38.8 million (€25.2 million) as at March 31, 2007, and was included in the amount disclosed in Note 12 to the consolidated financial statements.

We negotiated new financing for the Zhuhai Training Centre this year. The recorded debt represents our 49% share of term debt to acquire simulators and repay existing debt maturities, on a non-recourse basis, for the joint venture. The term debt was arranged through several financial institutions. Borrowings bear interest on a floating rate of U.S. Libor plus a spread, and have maturities between March 2008 and December 2009. According to the debt agreements, the joint venture may draw an additional US$6.4 million (our proportionate 49% share is US$3.1 million) in fiscal 2008 to pay for simulators. We had $20.4 million outstanding (US$17.7 million) as at March 31, 2007. This is included in the amount disclosed in Note 12 to the consolidated financial statements.

Pension obligations

We maintain defined benefit and defined contribution pension plans. We expect to contribute approximately $3.0 million more than the annual required contribution for current services to satisfy a portion of the underfunded liability of the defined benefit pension plan. We will continue to contribute to the underfunded liability until we have met the plan's funding obligations.

7.2 VARIABLE INTEREST ENTITIES

Note 26 to the consolidated financial statements summarizes the total assets and total liabilities of the significant entities we have a variable interest in (variable interest entities or VIEs). They are listed by segment and include sale and leaseback entities and partnership arrangements.

Sale and leaseback

We have entered into sale and leaseback arrangements with special purpose entities (SPEs). These arrangements relate to FFSs used for civil and military aviation in our training centres. These leases expire at different times up to 2023. Generally, we have the option of buying the equipment at a specific price at a specific time during the term of the lease. Some leases include renewal options at the end of the term. In some cases, we provided guarantees of the residual value of the equipment when the leases expire or on the day we exercise our purchase option.

These SPEs are financed by secured long-term debt and third-party equity investors who sometimes benefit from tax incentives. The equipment serves as collateral for the SPE's long-term debt.

Our variable interests in these SPEs are solely through fixed purchase price options and residual value guarantees, except in one case where the variable interest is equity and a subordinated loan. At the end of fiscal 2006, we also had a variable interest in another SPE through a cost sharing construction agreement. The agreement ended this year so we no longer have a variable interest in this SPE.

We also provide administrative services to the SPE for a fee.

Some of these SPEs are VIEs. At the end of fiscal 2007 and 2006, we were the primary beneficiary for one of them. The assets and liabilities of this VIE are fully consolidated in our consolidated financial statements as at March 31, 2007 and 2006, before we classified it as a VIE and CAE as the primary beneficiary.

We are not the primary beneficiary for any of the other SPEs that are VIEs, and consolidation is not appropriate under AcG-15. Our maximum potential exposure to losses relating to these non-consolidated SPEs was $47.1 million at the end of fiscal 2007 ($47.7 million in 2006).

Partnership arrangements

We enter into partnership arrangements to provide military simulation products and training and services for the military and civil segments.

Our involvement with entities related to these partnership arrangements is mainly through investments in their equity and/or in subordinated loans and manufacturing and long-term training and services contracts. While some of these entities are VIEs, we are not the primary beneficiary so these entities have not been consolidated. We continue to account for these investments under the equity method and record our share of the net earnings or loss based on the terms of the partnership arrangement. As at March 31, 2007 and 2006, our maximum off-balance sheet

exposure to losses related to these non-consolidated VIEs, other than from their contractual obligations, was not material.

7.3 OFF BALANCE SHEET ARRANGEMENTS

Most of our off balance sheet obligations are from operating lease obligations related to two segments:

- The TS/C segment, which operates a fleet of over 100 simulators in our training centres. We have entered into sale and leaseback transactions with a number of different financial institutions and treat them as operating leases.
- The TS/M segment, which operates a training centre for a specific project with the U.K. Ministry of Defence to provide simulation services. The operating lease commitments are between the operating company (which has the service agreement with the U.K. Ministry of Defence) and the asset company (which owns the assets). These leases are non-recourse to CAE.

Sale and leaseback transactions

The sale and leaseback of certain FFSs installed in our global network of training centres is a key element in our financing strategy to support investment in the civil and military training and services business. It provides us with a cost-effective, long-term source of fixed-cost financing. A sale and leaseback transaction can only be executed after a FFS has received certification by regulatory authorities and is installed and available to customers for training.

Sale and leaseback transactions are generally structured as leveraged leases with an owner participant. Before completing a sale and leaseback consolidated transaction, we record the cost to manufacture the simulator as a capital expenditure, and include it as a fixed asset on the consolidated balance sheet. When the sale and leaseback transaction is executed, we record the transaction as a disposal of a fixed asset and the cash proceeds are about the same as the fair market value of the FFS.

We record the difference between the proceeds received and our manufacturing cost (roughly the margin that we would record if we had completed a FFS sale to a third party) under deferred gains and other long-term liabilities. We then amortize it over the term of the sale and leaseback transaction as a reduction of rental expense, net of the guaranteed residual value where appropriate. At the end of the term of the sale and leaseback transaction, we take the guaranteed residual value into income if the value of the underlying FFS has not decreased.

We did not enter into any additional sale and leaseback transactions this year. In fiscal 2006, we bought back five FFSs that had initially been financed under a sale and leaseback transaction for a total consideration of $47.3 million. We also completed the refinancing of two FFSs for a net asset value of US$13.8 million, and converted one FFS from an operating lease into a capital lease to minimize the tax impact associated with the relocation of the FFS to the Brazil training centre. As a result, proceeds from the sale and leaseback of assets are nil for this year and last year.

The table below lists sale and leaseback transactions for FFSs that were in service in TS/C training centres as of March 31, 2007. They appear as operating leases in our consolidated financial statements.

Existing FFSs under sale and leaseback

(amounts in millions, unless otherwise noted)	Fiscal year	Number of FFSs (units)	Lease obligations	Initial term (years)	Imputed interest rate	Unamortized deferred gain	Residual value guarantee
SimuFlite	2002 to 2005	14	$ 167.2	10 to 20	5.5% to 6.7%	$ 12.2	$ -
Toronto training centre	2002	2	37.4	21	6.4%	15.4	9.2
Air Canada training centre	2000	2	27.7	20	7.6%	13.7	8.2
Denver/Dallas training centres	2003	5	72.3	20	5.0%	27.1	–
China Southern joint venture (1)	2003	5	18.2	15	3.0%	–	–
Other	–	5	15.3	3 to 8	2.9% to 7.0%	15.6	34.7
		33	$ 338.1			$ 84.0	$ 52.1
Annual lease payments (upcoming 12 months)			$ 33.8				

(1) We have a 49% interest in this joint venture.

The rental expenses related to operating leases of the FFSs under the sale and leaseback arrangements were $32.4 million for fiscal 2007, compared to $38.3 million last year.

You can find more details about operating lease commitments in Notes 21 and 26 to the consolidated financial statements.

7.4 FINANCIAL INSTRUMENTS

We are exposed to various financial risks in the normal course of our business. We enter into forward, swap and option contracts to manage our exposure to fluctuations in foreign exchange rates, interest rates and changes in share price which have an effect on our stock-based compensation costs. We also continually assess whether the derivatives we use in hedging transactions are effective in offsetting changes in fair value or cash flows of hedged items. We enter into these transactions to reduce our exposure to risk and volatility, and not for speculative reasons. We only deal with highly rated counterparties.

Our policy is to hedge every new foreign currency-denominated manufacturing contract when it is signed and executed. We only hedge future revenue exposure when contracts are signed. We have adopted a contract-by-contract hedging strategy, rather than an overall strategy based on the contracts we expect to sign. We eliminate the risk associated with the signed contracts by entering into forward exchange contracts (see Note 18 to the financial statements for more details). At the end of fiscal 2007, approximately 14% of the total value of the outstanding contracts were not hedged. The non-hedged portion relates mainly to a former contract and provides a natural hedge to certain purchases that are open to currency exposure.

We enter into foreign exchange forward contracts to manage our exposure when we make a sale in a foreign currency. The amount and timing of the maturity of these forward contracts varies depending on a number of factors, including milestone billings and the use of foreign materials and/or sub-contractors. We had $604.1 million Canadian-dollar equivalent in forward contracts at the end of fiscal 2007, compared to $322.3 million at the end of the previous year. The increase was mainly because of a higher number of foreign currency denominated revenue contracts being hedged, as well as some additional hedging for purchase related exposure. We use financial instruments to manage our exposure to changing interest rates and to adjust our mix of fixed and floating interest rate debt on long-term debt. The mix was 60% fixed-rate and 40% floating-rate at the end of this year, compared to 62% fixed-rate and 38% floating-rate at the end of fiscal 2006.

We also hedge to reduce our exposure to changes in our share price because it affects the cost of our deferred share unit (DSU) programs. A settlement hedge contract covered 1,495,000 CAE shares as at March 31, 2007, compared to 600,000 the previous year. We used the following methods and assumptions to estimate the fair value of the financial instruments:

- Cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities are valued at their carrying amounts on the consolidated balance sheet. This is an appropriate estimate of their fair value because of their short-term maturities.
- Capital leases are valued using the discounted cash flow method.
- The value of long-term debt is estimated based on discounted cash flows using current interest rates on 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 on the date of the consolidated balance sheet.
- Forward foreign exchange contracts are valued using the estimated amounts that we would receive or pay to settle the contracts on the date of the consolidated balance sheet.

The table below lists the fair value and the carrying amount of the financial instruments as at March 31:

(amounts in millions)	**2007**		2006	
	Fair value	**Carrying amount**	Fair value	Carrying amount
Long-term debt	**$ 288.5**	**$ 283.2**	$ 277.9	$ 271.3
Net forward foreign exchange contracts	**(7.6)**	**–**	5.4	–
Interest rate swap contracts	**1.0**	**–**	(1.5)	–

8. ACQUISITIONS, BUSINESS COMBINATIONS AND DIVESTITURES

8.1 ACQUISITIONS AND JOINT VENTURES

Kesem International PTY Ltd

On December 22, 2006, CAE acquired all the issued and outstanding shares of Kesem International Pty Ltd (Kesem), which offers a range of professional services to support design, analysis and experimentation in the defence and homeland security markets. Total consideration for this acquisition, excluding acquisition costs of $0.3 million, was AUD$5.0 million ($4.6 million) payable in cash in four instalments as follows:

i. AUD$3.5 million ($3.1 million) at closing date.

ii. AUD$0.5 million ($0.5 million) in fiscal 2007.

iii. AUD$0.5 million ($0.5 million) in fiscal 2008.

iv. AUD$0.5 million ($0.5 million) in fiscal 2009.

In the fourth quarter of fiscal 2007, the parties agreed to the distributable working capital adjustment and no significant adjustment was required.

Emirates-CAE Flight Training Centre (ECFT) joint venture company

On October 4, 2006, we decided, with Emirates, to strengthen our partnership by transforming an existing teaming agreement into a 50/50 joint venture company. ECFT provides training for airline and business aircraft pilots for specific types of aircraft, training for aircraft maintenance personnel for particular aircraft and maintenance services for training devices. The two parties have agreed to transfer their existing Dubai flight training assets to ECFT, to be entitled to equal profits, losses and dividends of the business and to share equally in managing all operating, financing and investing activities of the joint venture company.

Terrain Experts Inc.

On May 20, 2005, we acquired all the issued and outstanding shares of Terrain Experts Inc. (Terrex), which develops software tools for terrain database generation and visualization. Total consideration for this acquisition was US$11.1 million ($14.0 million) payable in common shares issued by CAE and a nominal cash portion in three instalments as follows:

i. 1,000,000 shares representing US$4.8 million (approximately $6.1 million issued at a price of $6.13 per share, the closing price of the common shares on the Toronto Stock Exchange (TSX) on May 20, 2005), and US$0.2 million ($0.3 million) together in cash

representing US$5.0 million ($6.4 million) at the closing date.

ii. US$3.6 million through the issuance of CAE shares in fiscal 2007 (12 months following the closing of the acquisition) to be calculated at the TSX stock price on the date of issuance. In fiscal 2007, we settled the second instalment of the payment related to the acquisition in the amount of US$3.6 million with cash rather than shares.

iii. US$2.5 million through the issuance of CAE shares in fiscal 2008 (24 months following the closing of the transaction) to be calculated at the TSX stock price on the date of issuance, which we may settle in cash rather than shares.

In fiscal 2007, we completed the purchase price allocation for this acquisition, and no adjustments were required.

CAE Professional Services (Canada) Inc. (formerly identified as Greenley & Associates Inc.)

On November 30, 2004, we acquired all the issued and outstanding shares of CAE Professional Services C anada) Inc. (formerly Greenley & Associates Inc. G &A]), which provides project management, human factors, modelling and simulation services. Total consideration for this acquisition was $4.4 million, payable in equivalent common shares issued by CAE in four instalments as follows: 424,628 shares (representing $2.0 million) at the closing date, $0.8 million in fiscal 2006, $0.8 million in fiscal 2007, and 169,851 shares (representing $0.8 million at the transaction date) to be issued on November 30, 2007.

The number of shares to satisfy the first and the fourth payments was calculated based on the average closing share price ($4.71 per share) of CAE common shares on the TSX for the 20-day period ending two days prior to November 30, 2004. The 91,564 shares issued to satisfy the second payment was based on the average closing share price of CAE common shares on the TSX for the 20-day period ending two days before the date of issuance ($8.07 per share). The third payment of $0.8 million was initially considered to be satisfied through the issuance of shares based on the average closing share price of CAE common shares on the TSX for the 20-day period ending two days before the date of issuance. In fiscal 2007, however, we settled the third payment with cash rather than shares. In the second quarter of fiscal 2006, we completed the purchase price allocation for this acquisition, and no adjustments were required.

Servicios de Instruccion de Vuelo, S.L.

In February 2004, CAE and Iberia Lineas Aereas de España, SA (Iberia) agreed to combine their aviation training operations in Spain after receiving regulatory clearance from the Spanish authorities to start operations, under an agreement entered into in October 2003. On May 27, 2004, in connection with the financing of the combined operations, Iberia and CAE Servicios Globales de Instruccion de Vuelo (España), S.L. (SGIV), a wholly-owned subsidiary of CAE, contributed the net assets of their respective training centre facilities to Servicios de Instruccion de Vuelo, S.L. (SIV), with SGIV obtaining ownership of 80% of SIV. SIV financed the acquisition of the assets from SGIV and Iberia through an asset-backed financing transaction (see Note 12 to the financial statements for more details).

As part of this transaction, if the October 2003 agreement is terminated, SGIV and Iberia will be obliged to repurchase the assets they contributed, in proportion to the fair market value of the assets, for a total amount equal to the outstanding balance under the financing transaction.

As part of the May 27, 2004 agreement, Iberia was to subsequently transfer a simulator that it was leasing from a third party to SIV, in exchange for a cash consideration of $5.7 million (€3.5 million). This transaction was accounted for as an increased contribution of property, plant and equipment and in long-term debt with a cash consideration equivalent to the net asset value.

In addition, as part of the agreement, SIV has agreed to fund an amount up to a maximum of $2.4 million (€1.5 million) to cover any payments made by Iberia to former employees in order to indemnify Iberia for potential costs to be incurred due to certain employment matters. Based on management's best estimate of SIV's potential liability, $2.4 million (€1.5 million) has been accrued as part of the purchase price and accounted for as goodwill.

Flight Training Centre Chile S.A.

On April 22, 2004, we acquired all the issued and outstanding shares of Flight Training Centre Chile S.A. (FTC Chile, located in Santiago, Chile) from LAN Chile S.A. for total cash consideration of $0.9 million (US$0.7 million). The balance of the purchase price was paid in two instalments of US$0.3 million in fiscal 2006 and US$0.8 million in fiscal 2007. This acquisition expanded our pilot-training operations into the South American market.

8.2 DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE

Discontinued operations

Marine Controls

On February 3, 2005, we completed the sale of the substantial components of the Marine Controls segment to L-3 Communications Corporation (L-3), for a cash consideration of $238.6 million. This amount was subject to the approval by L-3 of the net working capital of the Marine Controls segment. The parties completed the discussions regarding the net working capital in the second quarter of fiscal 2007 and L-3 was paid for the difference in the net working capital. We received from L-3 in fiscal 2007, notices of claims for indemnification pursuant to the Sale and Purchase Agreement (SPA), including in respect of allegations that we were in breach of certain representations and warranties in the SPA. At this time, neither the outcome of these matters nor the potential future payments, if any, are determinable. We intend to assert all available defences against these claims. The aggregate liability for claims made under the SPA is limited to US$25 million.

During the second and third quarters of fiscal 2006, according to the purchase agreement, L-3 acquired the two components of the Marine Controls segment that were subject to regulatory approvals, and assumed our guarantee of $53.0 million (£23 million) of project-financed related debt for the U.K. Astute Class submarine training program.

The results of the Marine Controls segment have been reported as discontinued operations since the second quarter of fiscal 2005. Interest expense relating to debt not directly attributable to the continuing operations and paid with the proceeds of the sale of the Marine Controls business has been allocated to discontinued operations based on its share of net assets.

Cleaning Technologies and Other Discontinued Operations

In fiscal 2004, we completed the sale of our last Cleaning Technologies business, Alpheus Inc., to Cold Jet Inc. We were entitled to receive further consideration based on the performance of the business until 2007 and also had certain obligations to Cold Jet Inc. In fiscal 2006, an agreement was reached to settle the further consideration and cancel our outstanding obligations. Cold Jet paid us an amount of $0.2 million.

In the second quarter of fiscal 2007, we received early payment, in full, of $9.3 million in secured subordinated promissory long-term notes previously recorded in other assets. These notes, with a carrying value of $7.9 million, were received by CAE as part of the consideration for its sale in 2002 of Ultrasonics and Ransohoff. The repayment resulted in the recognition of $1.4 million of interest revenue during the second quarter due to the accretion of discounts on the long-term notes receivable. The parties have also concluded discussions regarding adjustments to working capital provisions. As a result of these discussions, we collected and recorded an additional amount of approximately $0.1 million (net of tax recovery of $0.1 million).

Also, in fiscal 2006, we incurred additional costs of $3.4 million related to our former Cleaning Technologies business mostly in connection with the revaluation of a pension liability and the reversal of an unrecognized tax asset, and recorded $0.9 million for other discontinued operations.

Forestry Systems

On May 2, 2003, we completed the sale of one of our Forestry Systems businesses to Carmanah Design and Manufacturing. We were entitled to receive further consideration based on the performance of the business. In the first quarter of fiscal 2007, a settlement was concluded and we received a payment of $0.2 million (net of tax expense of $0.1 million).

On August 16, 2002, we sold substantially all the assets of the sawmill division of Forestry Systems. We were entitled to receive further cash consideration from the sale based on operating performance of the disposed business for the three-year period from August 2002 to August 2005. In November 2005, we were notified by the buyers that, in their view, the targeted level of operating performance which would trigger further payment had not been achieved. We have completed a review of the buyers' books and records and, in January 2006 launched legal proceedings to collect the payment that we believe is owed to us. In the fourth quarter of fiscal 2007, we recognized fees in connection with the evaluation and litigation exercise amounting to $0.9 million (net of tax recovery of $0.2 million). For fiscal 2006, the Company incurred $0.2 million (net of tax recovery of $0.1 million). In fiscal 2005, no such fees were incurred. This dispute has been referred to arbitr ation and is currently in the discovery of evidence phase.

Long-term assets held for sale

As part of our global expansion, we announced in the third quarter of fiscal 2005 that we would be opening a new business aviation-training centre in Morris County, New Jersey. The new training centre became operational in fiscal 2007. As a result, the valuation of two redundant training centre buildings, one located in Dallas, Texas and a second located in Marietta, Georgia, were adjusted to their fair value in fiscal 2005 and reclassified as assets held for sale, and previously reported amounts have been reclassified. Also, as part of a review of our performance and strategic orientation, we decided to close our training centre located in Maastricht, Netherlands in the third quarter of fiscal 2006. As a result, the property was reclassified as an asset held for sale.

In the second quarter of fiscal 2007, we sold for $3.6 million the aggregate land and building in Dallas, Texas and Marietta, Georgia, which was previously reported as assets held for sale. As a result of this transaction, we recorded a loss on the sale of $0.2 million (net of tax recovery of $0.1 million).

In the last quarter of fiscal 2007, we sold the remaining long-term assets held for sale in Maastricht, Netherlands for $2.8 million. As a result of this transaction, we recorded a gain on the sale of $0.2 million (net of tax expense of $0.1 million).

9. BUSINESS RISK AND UNCERTAINTY

We operate in several industry segments that have various risks and uncertainties. Management and the board discuss the principal risks facing our business, particularly during the annual strategic planning and budgeting processes. These are described below. Management attempts to mitigate risks that may affect our future performance through a process of identifying, assessing, reporting and managing risks that are significant from a corporate perspective.

Length of sales cycle

The sales cycle for our products and services is long and unpredictable, ranging from six to 18 months for civil aviation applications and from six to 24 months or longer for military applications. During the time when customers are evaluating our products and services, we may incur expenses and management time. Making these expenditures in a quarter that has no corresponding revenue will affect our operating results and could increase the volatility of our share price.

Product evolution

The civil aviation and military markets we operate in are characterized by changes in customer requirements, new aircraft models (Boeing 777) and evolving industry standards such as our CAE 5000 Series recently launched. If we do not accurately predict the needs of our existing and prospective customers or develop product enhancements that address evolving standards and technologies, we may lose current customers and be unable to bring on new customers. This could reduce our revenue. The evolution of the technology could also have an impact on the value of our fleet of FFSs.

Level of defence spending

A significant portion of our revenue comes from sales to military customers around the world. In fiscal 2007, for example, sales by the SP/M and TS/M segments accounted for 45% of our revenue. We are either the primary contractor or a subcontractor for various programs by Canadian, U.S., European, and other foreign governments. If funding for a government program is cut, we could lose future revenue, which could have a negative effect on our operations. If countries we have contracts with significantly lower their military spending, there could be a material negative effect on our sales and earnings.

Civil aviation industry

A significant portion of our revenue comes from supplying equipment and training services to the commercial and business airline industry.

While major airlines continue to face financial difficulties, we have seen a surge of new aircraft orders in 2007, which is encouraging. Most of these aircraft are destined for carriers in the Middle East and Asia.

Fluctuating prices for airplane fuel also have a material effect on the profitability of many airlines. If fuel prices remain high for a sustained period, deliveries of new aircraft could be delayed or cancelled, which would negatively affect the demand for our training equipment and services.

We are also exposed to credit risk on accounts receivable from our customers, but have adopted policies to ensure we are not significantly exposed to any individual customer. Our policies include analyzing the financial position of our customers and regularly reviewing their credit quality. We also subscribe from time to time to credit insurance and, in some instances, require a bank letter of credit.

Competition

We sell our simulation equipment and training services in highly competitive markets, and new entrants are emerging and positioning themselves to take advantage of a positive market outlook. Some of our competitors are larger than we are, 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 when competing for projects for these organizations.

We obtain most of our contracts through competitive bidding processes that subject us to the risk of spending a substantial amount of time and effort on proposals for contracts that may not be awarded to us. We cannot be certain that we will continue to win contracts through competitive bidding processes at the same rate as we have in the past.

Foreign exchange

Approximately 90% of our revenue is generated in foreign currencies and this will continue to be the case. Conversely, a smaller proportion of our operating expenses are in Canadian dollars. Any significant change in the value of the Canadian dollar will cause volatility in our results of operations, cash flow and financial condition from period to period. We have developed various cash flow hedging programs to partly offset this exposure. The Canadian dollar has also made Canada a more expensive manufacturing environment for us. If the Canadian dollar increases in value it will negatively affect our financial results and our competitive position compared to other equipment manufacturers in jurisdictions where operating costs are lower.

Doing business in foreign countries

We have operations in many countries and sell our products and services to customers around the world. Sales to customers outside Canada and the U.S. made up approximately 60% of revenue in fiscal 2007. We expect sales outside Canada and the U.S. to continue to represent a significant portion of revenue for the foreseeable future. As a result, we are subject to the risks of doing business internationally.

These include foreign exchange risk, as discussed above, and the risk that laws and regulations in host countries will change, which can have an effect on:

- the cost and complexity of using foreign representatives and consultants
- tariffs, embargoes, controls and other restrictions that may affect the free flow of goods, information and capital
- the complexities of managing and operating an enterprise and complying with laws in multiple jurisdictions
- general changes in economic and geopolitical conditions.

Our currency hedging activities may not successfully mitigate foreign exchange risk.

Fixed-price and long-term supply contracts

We provide our products and services mainly through fixed-price contracts that require us to absorb cost overruns, even though it can be difficult to estimate all of the costs associated with these contracts or to accurately project the level of sales we may ultimately achieve. In addition, a number of contracts to supply equipment and services to commercial airlines are long-term agreements that run up to 20 years. While these contracts can be adjusted for increases in inflation and costs, the adjustments may not fully offset the increases, which could negatively affect the results of our operations.

ntegration risk

Our business could be negatively affected if our products do not successfully integrate or operate with other sophisticated software, hardware, computing and communications systems that are also continually evolving. If we experience difficulties on a project or do not meet project milestones, we may have to devote more engineering and other resources than originally anticipated. While we believe we have recorded adequate provisions for losses on fixed-price contracts, it is possible that fixed-price and long-term supply contracts could subject us to additional losses that exceed obligations under the terms of the contracts.

Government-funded military programs

Like most companies that supply products and services to governments, we can be audited and reviewed from time to time. Any adjustments that result from government audits and reviews may have a negative effect on our results of operations. Some costs may not be reimbursed or allowed in negotiations of fixed-price contracts. We may also be subject to a higher risk of legal actions and liabilities than companies that cater only to the private sector, which could have a materially negative effect on our operations.

If we fail to comply with government regulations and requirements, we could be suspended or barred from government contracts or subcontracts for a period of time, which would negatively affect our revenue from operations and profitability and could have a negative effect on our reputation and ability to procure other government contracts in the future.

Research and development activities

We have carried out some of our research and development initiatives with the financial support of government agencies, including the Government of Canada through Technology Partnerships Canada and the Government of Québec through Investissement Québec. If we do not receive this financial support in the future, there is a risk that we may not be able to replace this with other assistance.

Protection of intellectual property

We rely in part on trade secrets and contractual restrictions, such as confidentiality agreements and licences, to establish and protect our proprietary rights. These may not be effective in preventing a misuse of our technology or in deterring others from developing similar technologies. We may be limited in our ability to acquire or enforce our intellectual property rights in some countries.

Intellectual property

Our products contain sophisticated software and computer systems that are supplied to us by third parties. These may not always be available to us. Our production of simulators often depends on receiving confidential or proprietary data on the functions, design and performance of a product or system that our simulators are intended to simulate. We may not be able to obtain this data on reasonable terms, or at all.

Infringement claims could be brought against us or against our customers. We may not be successful in defending these claims and we may not be able to develop processes that do not infringe on the rights of third parties, or obtain licences on terms that are commercially acceptable, if at all.

Litigation related to our intellectual property rights could be lengthy and costly and could negatively affect our operations or financial results, whether or not we are successful in defending a claim.

Environmental liabilities

We use, generate, store, handle and dispose of hazardous materials at our operations, and our past operations. Past operators at some of our sites also carried out these activities.

New laws and regulations, stricter enforcement of existing laws and regulations, the discovery of previously unknown contamination, new clean-up requirements or claims on indemnities we have given may mean we have to incur substantial costs. This could have a materially negative effect on our financial condition and results of operations.

We have made provisions for claims we know about and remediation we expect will be required, but there is a risk that our provisions are not

sufficient.

In addition, our discontinued operations are largely uninsured against such claims, so an unexpectedly large environmental claim against a discontinued operation could reduce our profitability in the future.

Liability claims arising from casualty losses

Because of the nature of our business, we may be subject to liability claims, including claims for serious personal injury or death, arising from accidents or disasters involving training equipment we have sold or aircraft for which we have provided training equipment or services. We may also be subject to product liability claims relating to equipment and services our discontinued operations sold in the past. We cannot be certain that our insurance coverage will be sufficient to cover one or more substantial claims.

Warranty or other product-related claims

We manufacture simulators that are highly complex and sophisticated. These may contain defects that are difficult to detect and correct. If our products fail to operate correctly or have errors, there could be warranty claims or we could lose customers. Correcting these defects could require significant capital investment. If a defective product is integrated into our customer's equipment, we could face product liability claims based on damages to the customer's equipment. Any claims, errors or failures could have a negative effect on our operating results and business. We cannot be certain that our insurance coverage will be sufficient to cover one or more substantial claims.

Regulatory rules imposed by aviation authorities

We are required to comply with regulations imposed by aviation authorities. These regulations may change without notice, which could disrupt our sales and operations. Any changes imposed by a regulatory agency, including changes to safety standards imposed by aviation authorities such as the U.S. Federal Aviation Administration, could mean we have to make unplanned modifications to our products and services, cause delays and result in cancelled sales. We cannot predict the impact of changing laws or regulations might have on our operations. Any changes could have a materially negative effect on our results of operations or financial condition.

Sales or licences of certain CAE products require regulatory approvals

The sale or licence of virtually all of our products is subject to regulatory controls. These can prevent us from selling to certain countries, and require us to get an export licence or other approvals to sell certain technology such as military-related simulators or other training equipment, including military data or parts. These regulations change often and we cannot be certain that we will be permitted to sell or license certain products to customers, which can cause a potential loss of revenue for us. Failing to comply with any of these regulations in countries where we operate could result in fines and other material sanctions.

Key personnel

Our continued success will depend in part on our ability to retain and attract key personnel with the relevant skill, expertise and experience. Our compensation policy is designed to mitigate this risk.

Enterprise resource planning

We are investing time and money in a new ERP system. If the system does not operate as expected or when expected, it may be difficult for us to claim compensation or correction from the supplier. We may not be able to realize the expected value of the system and this may have a negative effect on our operations, profitability and reputation.

Integration of business acquired

The success of our acquisitions depend on our ability to cristallize synergies both in terms of broadening our product offering as well as consolidating the operations of the business acquired as part of our existing operations.

10. CHANGES IN ACCOUNTING STANDARDS

10.1 SIGNIFICANT CHANGES IN ACCOUNTING STANDARDS – FISCAL 2005 TO 2007

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

Stock-based compensation for employees eligible to retire before the vesting date

In the third quarter of fiscal 2007, we adopted EIC-162, *Stock-Based Compensation for Employees Eligible to Retire Before the Vesting Date* . This change was required for all companies under Canadian GAAP for interim financial statements ending on or after December 31, 2006.

The abstract stipulates that the stock-based compensation expense for employees who will become eligible for retirement during the vesting period be recognized over the period from the grant date to the date the employee becomes eligible to retire. In addition, if an employee is eligible to retire on the grant date, the compensation expense must be recognized at that date. The abstract also requires us to retroactively restate prior periods.

Adopting EIC-162 had the following impact on our consolidated financial statements:

- It increased contributed surplus by $0.2 million on April 1, 2005, and decreased contributed surplus by $0.2 million on April 1, 2006.
- It resulted in a cumulative charge of $1.9 million to retained earnings on April 1, 2004, $1.6 million on April 1, 2005 and $2.9 million on April 1, 2006.
- It increased the stock-based compensation expense by $2.2 million for the fiscal year 2006 and no impact for fiscal 2005.
- It had an impact on our basic and diluted earnings per share of $0.01 for fiscal 2006, and a nil impact for fiscal 2007 and fiscal 2005.

Consolidation of variable interest entities

On January 1, 2005, we adopted AcG-15, *Consolidation of Variable Interest Entities*, retroactively, without restating prior periods. AcG-15 provides a framework for identifying variable interest entities (VIEs) and determining when an entity should include the assets, liabilities and results of operations of a VIE in its consolidated financial statements.

In general, a VIE is a corporation, partnership, limited-liability corporation, trust, or any other legal structure used to conduct activities or hold assets that either:

- Has an insufficient amount of equity to carry out its principal activities without additional subordinated financial support.
- Has a group of equity owners that are unable to make significant decisions about its activities, or
- Has a group of equity owners that do not have the obligation to absorb losses or the right to receive returns generated by its operations.

AcG-15 requires a VIE to be consolidated if a party with an ownership, contractual or other financial interest in the VIE (a variable interest holder) is exposed to a majority of the risk of loss from the VIE's activities, is entitled to receive a majority of the VIE's residual returns (if no party is exposed to a majority of the VIE's losses), or both (the primary beneficiary). Upon consolidation, the primary beneficiary generally must initially record all of the VIE's assets, liabilities and non-controlling interests at fair value at the date the enterprise became the primary beneficiary. For variable interest entities created before AcG-15 was initially adopted, the assets, liabilities and non-controlling interests of these entities must be initially consolidated as if the entities were always consolidated based on majority voting interest. AcG-15 also requires disclosure about VIEs that the variable interest holder is not required to consolid ate but in which it has a significant variable interest.

The adoption of AcG-15 on January 1, 2005 resulted in an increase in total assets, liabilities and retained earnings of $46.9 million, $43.7 million, and $3.3 million respectively and a decrease in the currency translation adjustment of $0.1 million in the fiscal 2005 consolidation financial statements.

The table below shows the impact on each item in the balance sheet as of January 1, 2005:

(amounts in millions)	Consolidated in fiscal 2005
Assets	
Property, plant and equipment, net	$ 46.9
	$ 46.9
Liabilities	
Accounts payable and accrued liabilities	$ 0.6
Long-term debt (including current portion)	41.3
Future tax liabilities	1.8
	$ 43.7
Shareholders' equity	
Retained earnings	$ 3.3
Currency translation adjustment	(0.1)
	$ 46.9

When we consolidated this VIE, we recognized liabilities that represent claims against the specific assets of the consolidated VIE, and not additional claims on our general assets. Assets recognized as a result of consolidating this VIE cannot be used to satisfy claims against our general assets. In addition, consolidating this VIE did not result in any change in the underlying tax, legal or credit exposure for us.

Generally accepted accounting principles and presentation of financial statements

On April 1, 2004, we adopted CICA Handbook Section 1100, *Generally Accepted Accounting Principles* and Section 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 reclassifying GAAP hierarchy. Section 1400 clarifies fair presentation according to GAAP and provides general guidance on financial presentation. Adopting these standards did not have any material effect on our consolidated financial statements.

Hedging relationships

On April 1, 2004, we adopted AcG-13, *Hedging Relationships*, and EIC-128, *Accounting for Trading, Speculative or Non-Hedging Derivative Financial Instruments* on a prospective basis. AcG-13 addresses the identification, designation, documentation and effectiveness of hedging relationships when applying hedge accounting and discontinuing the use of hedge accounting. It requires companies to document all information related to hedging relationships, including the effectiveness of the hedges. Adopting this guideline did not have a material effect on our consolidated financial statements.

Employee future benefits

On April 1, 2004, we adopted CICA Handbook Section 3461, *Disclosure Requirements Employee – Future Benefits* . It requires us to describe each type of plan, the date the plan assets and liabilities were valued, the effective date of the last actuarial evaluation and details of the plan assets by major category.

10.2 FUTURE CHANGES IN ACCOUNTING STANDARDS

Financial instruments – recognition and measurement hedges and comprehensive income

In January 2005, the Accounting Standards Board (AcSB) issued three new standards dealing with financial instruments: (i) Financial Instruments – Recognition and Measurement, (ii) Hedges and (iii) Comprehensive Income. These sections are required for public companies for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. These standards are based on U.S. FASB Statement 115 (*Accounting for Certain Investments in Debt and Equity Securities*), Statement 130 (*Reporting Comprehensive Income*), Statement 133 (*Accounting for Derivative Instruments and Hedging Activities*) and IAS 39 of the International Accounting Standards (IAS) Board (*Financial I nstruments – Recognition and Measurement*).

CICA Handbook Section 3855, *Financial Instruments – Recognition and Measurement* prescribes when a financial instrument should be recognized on the balance sheet and the method for measuring fair value or cost-based measures. It also specifies how financial instrument gains and losses should be presented.

CICA Handbook Section 3865, *Hedges* allows optional treatment as long as hedges are designated as either fair value hedges, cash flow hedges or hedges of a net investment in a self-sustaining foreign operation.

For a fair value hedge, the gain or loss that is attributed to the hedged risk is recognized in net income in the period of change, together with the offsetting loss or gain on the hedged item that is attributed to the hedged risk. The carrying amount of the hedged item is adjusted for the hedged risk.

For a cash flow hedge or for a hedge of a net investment in a self-sustaining foreign operation, the effective portion of the hedging item's gain or loss is initially reported in other comprehensive income and then reclassified as net income when the hedged item affects net income.

CICA Handbook Section 1530, *Comprehensive Income* and amended Section 3250, *Surplus* (renamed Section 3251, *Equity*) require enterprises to present comprehensive income and its components as well as net income in its financial statements, and to present separately changes in equity during the period and components of equity, including comprehensive income, at the end of the period.

We are currently evaluating the impact of this new standard.

Financial instrument – disclosures and presentation

In April 2005, the AcSB issued CICA Handbook Section 3861, *Financial instruments – Disclosure and presentation*. This section establishes standards for presentation of financial instruments and non-financial derivatives and identifies information that should be disclosed about them. This section applies to fiscal years beginning on or after October 1, 2006. In December 2006, the AcSB issued CICA Handbook Section 3862, *Financial instruments – Disclosures* and Section 3863, *Financial instruments – Presentation*. These standards revise Section 3861. Under these new sections, entities will be required to disclose information that enables users to evaluate the significance of a financial instrument to an entity's financia l position and performance. These sections apply to fiscal years beginning on or after October 1, 2007. We are currently evaluating the impact of this new standard.

Accounting changes

In 2006, the CICA has issued a new section of the CICA Handbook, Section 1506, *Accounting Changes*. The application of this section is required for public companies for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2007. This new section establishes criteria for changes in accounting policies, along with the accounting treatment and disclosure regarding changes in accounting policies, estimates and correction of errors. This standard will be applied prospectively beginning April 1st, 2007. We are currently evaluating the impact of this new standard.

Capital disclosure

In December 2006, the AcSB issued Handbook Section 1535, *Capital Disclosures*, which establishes guidelines for the disclosure of information regarding an entity's capital and how it is managed. This standard requires disclosure of an entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital and whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. This standard is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. We are currently evaluating the impact of this new standard.

Inventories

In March 2007, the AcSB approved new Section 3031, *Inventories*, which will replace existing Section 3030 with the same title. The new section establishes that inventories should be measured at the lower of cost and net realizable value, with guidance on the determination of cost, including allocation of overheads and other costs to inventory and requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The final standard is expected to be issued by mid 2007 effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. We are currently evaluating the impact of this new standard.

10.3 CRITICAL ACCOUNTING ESTIMATES

Because we prepare our consolidated financial statements according to GAAP, we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses for the period reported. We regularly review the estimates as they relate to the following areas, among others:

- Accounting for long-term contracts.
- Useful lives.
- Employee future benefits.
- Income taxes.
- Impairment of long-lived assets.
- Goodwill.

Management makes these estimates based on its best knowledge of current events and actions that we may undertake in the future. Significant changes in estimates and/or assumptions could result in impairment of certain assets, and actual results could differ from those estimates.

Our critical accounting policies are those that we believe are the most important in determining its financial condition and results and require significant subjective judgment by management. We consider an accounting estimate to be critical if it requires management to make assumptions about matters that were highly uncertain at the time the estimate was made, if different estimates could have reasonably been used or if there are likely to be changes, from period to period, in the estimate that would have a material effect on our financial condition or results of operations.

See the *Notes to the consolidated financial statements* for a summary of our significant accounting policies, including the accounting policies discussed below.

Revenue recognition

Multiple-element arrangements

We sometimes enter into multiple-element revenue arrangements which may include, for example, a combination of designing, engineering and manufacturing of flight simulators, spare parts and maintenance.

A multiple-element arrangement is separated into more than one unit of accounting, and applicable revenue recognition criteria is considered separately for the different units of accounting if all of the following criteria are met:

- The delivered item has value to the customer on a stand-alone basis.
- There is objective and reliable evidence of the fair value of the undelivered item (or items).
- If the arrangement includes a general right of return for the delivered item and delivery or performance of the undelivered item is likely and largely in the control of the vendor.

The allocation of the revenue from a multiple deliverable agreement is based on fair value of an undelivered item as evidenced by the price of the item regularly charged by the Company on an individual basis or on other basis' covered by the concept of vendor-specific objective evidence as presented in the Statement of Position (SOP) 97-2, *Software Revenue Recognition* issued by the American Institute of Certified Public Accountants. The Company does enter into stand-alone transactions on a regular basis in regards to the sale of spare parts and maintenance arrangements, therefore the price charged when the elements are sold separately is readily available. The process for determining fair value of undelivered items, with respect to the design, engineering and manufacturing of flight simulators, entails evaluating each transaction and taking into account the unique features of each de al. The applicable revenue recognition criteria for the separated units of accounting in regards to the individual design, engineering and manufacturing of flight simulators, spare parts and maintenance elements are described below.

Long-term contracts

We recognize revenue from long-term contracts for the design, engineering and manufacturing of flight simulators using the percentage-of-completion method when there is persuasive evidence of an arrangement, when the fee is fixed or determinable, and when collection is reasonably certain. Under this method, revenue and earnings are recorded as related costs are incurred, based on the percentage of actual costs incurred to date relative to the estimated total costs to complete the contract. The cumulative effect of any revisions to cost and earnings estimates are reflected in the period in which the need for a revision becomes known. Provision for estimated contract losses, if any, are recognized in the period in which the loss is determined.

We measure contract losses by the amount the estimated total costs exceed the estimated total revenue from the contract. We record warranty provisions when revenue is recognized, based on past experience. We generally do not provide customers with a right of return or complimentary upgrade. We bill customers for post-delivery support separately and recognize revenue over the support period.

Product maintenance

We recognize revenue from maintenance contracts in earnings on a straight-line basis over the contract period. In situations where it is clear that we will incur costs other than on a straight-line method, based on historical evidence, we recognize revenue over the contract period in proportion to the costs we expect to incur in performing services under the contract.

Spare parts

Revenue from the sale of spare parts is recognized when there is persuasive evidence of an arrangement, delivery has occured, the fee is fixed or determinable and collection is reasonably assured.

Software arrangements

We also enter into software arrangements to sell, independently or in multiple-element arrangements, standalone software, services, maintenance and software customization. We recognize revenue from software arrangements according to the guidance set out in SOP 97-2 as described in more detail as follows:

(i) Stand-alone products

Revenue from software licence arrangements that do not require significant production, modification, or customization of software, is recognized when there is persuasive evidence of an arrangement, delivery has occurred, the fee is fixed or determinable and collection is reasonably assured.

(ii) Consulting services

Revenue from direct consulting or training services that are provided to customers are recognized as the services are rendered.

(iii) Maintenance

Maintenance and support revenues are recognized ratably over the term of the related agreements.

(iv) Multiple-element arrangements

We sometimes enter into multiple-element revenue software arrangements, which may include any combination of software, services or training, customization and maintenance. In these instances, the fee is allocated to the various elements as previously described.

(v) Long-term software arrangements

Revenue from fixed-price software arrangements and software customization contracts that require significant production, modification or customization of software are also recognized under the percentage-of-completion method.

Training services

We recognize training services when there is persuasive evidence of an arrangement, the fee is fixed or can be determined, recovery is reasonably certain and the services have been rendered.

Income taxes

We use the tax liability method to account for income taxes. Under this method, future income tax assets and liabilities are determined according to differences between the carrying value and the tax bases of assets and liabilities.

This method also requires us to recognize future tax benefits, such as net operating loss carry forwards, when the realization of these benefits is more likely than not. A valuation allowance is recognized when, in management's opinion, it is more likely than not that the future income tax assets will not be realized.

We measure future tax assets and liabilities by applying rates and laws that have been enacted or substantively enacted at the date of the consolidated financial statements for the years when we expect the temporary differences to be reversed.

We do not provide for income taxes on undistributed earnings of foreign subsidiaries that are not expected to be repatriated in the foreseeable future.

We deduct investment tax credits (ITCs) from research and development (R&D) activities from the related costs, and include them in the determination of net earnings (loss) when there is reasonable assurance that the credits will be realized. ITCs from the acquisition or development of property, plant and equipment and deferred development costs are deducted from the cost of those assets, and amortization is calculated on the net amount.

We are subject to examination by taxation authorities in various jurisdictions. Because the determination of tax liabilities and ITC's recoverable involves certain uncertainties in interpreting complex tax regulations, we use management's best estimates to determine potential tax liabilities and ITCs. Differences between the estimates and the actual amount of taxes and ITCs are recorded in net earnings (loss) at the time they can be determined.

Valuation of goodwill and intangible assets

Goodwill is tested for impairment at least annually or more often if events or changes in circumstances indicate it might be impaired. We test for impairment by comparing the fair value of our reporting units with their carrying amount. When the carrying amount of the reporting unit exceeds the fair value, we compare, in a second step, the fair value of goodwill related to the reporting unit to its carrying value, and recognize an impairment loss equal to the excess. The fair value of a reporting unit is calculated based on one or more generally accepted valuation techniques.

We perform the annual review of goodwill as at December 31 of each year. Based on the impairment test performed as at December 31, 2004, we concluded that a goodwill impairment charge was required. We did not determine that a charge was required following the review as at December 31, 2005 and December 31, 2006.

We account for our 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 us to identify and attribute values and estimated lives to the intangible assets acquired. This involves considerable judgment and often involves the use of significant estimates and assumptions, including those relating to future cash flows, discount rates and asset lives. Determining these values and estimates subsequently affects the amount of amortization expense to be recognized in future periods over the intangible assets estimated useful lives.

Deferred development costs

We charge research costs to consolidated earnings (loss) in the period they are incurred. We also charge development costs to consolidated earnings (loss) in the period they are incurred unless they meet all of the criteria for deferral according to CICA Handbook Section 3450, *Research and Development Costs* and we are reasonably assured of their recovery. We deduct government contributions for research and development activities from the related costs or assets, if they are deferred. We start amortizing development costs deferred to future periods when the product is produced commercially, and we charge the costs to consolidated earnings (loss) based on anticipated sales of the product whenever possible, over a period of up to five years using the straight-line method.

Pre-operating costs

We defer costs incurred during the pre-operating period for all new operations related to training centres. Pre-operating costs are incremental in nature and management considers them to be recoverable from the future operations of the new training centre. We no longer capitalize costs when a training centre opens. We amortize deferred pre-operating costs over a five-year period using the straight-line method.

Deferred financing costs

We defer costs incurred with the issuance of long-term debt and amortize them on a straight-line basis over the term of the related debt. We amortize costs related to sale and leaseback agreements on a straight-line basis over the term of the lease.

Employee future benefits

We maintain defined benefit pension plans that provide benefits based on the length of service and final average earnings. The service costs and the pension obligations are actuarially determined using the projected benefit method prorated on employee service and management's best estimate of expected plan investment performance, salary escalation and retirement ages of employees. For the purpose of calculating the expected return on the plan assets, the relevant assets are valued at fair 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. Past service costs, arising from plan amendments, are deferred and amortized on a straight-line basis over the average remaining service life of active employees at the date of amendment.

When a curtailment arises, any unamortized past service costs associated with the reduction of future services is recognized immediately. Also, the increase or decrease in benefit obligations is recognized as a loss or gain, net of unrecognized actuarial gains or losses. Finally, when the restructuring of a benefit plan gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for prior to the settlement.

11. SUBSEQUENT EVENTS

ENGENUITY

In April 2007, the Company acquired 14,948,215 common shares of Engenuity Technologies Inc. (Engenuity) representing approximately 85.7% of the total outstanding number thereof. On May 25, 2007, the holders of common shares of Engenuity adopted a special resolution approving the amalgation of Engenuity with 4341392 Canada Inc., a wholly owned subsidiary of CAE Inc. per the amalgation agreement. As a result, Engenuity becomes a wholly owned subsidiary of CAE Inc. Engenuity develops commercial-off-the-shelf C OTS) simulation and visualization software for the aerospace and defence markets. Total consideration for this acquisition, including acquisition costs, amounted to $23.4 million in cash.

The preliminary fair value of net assets acquired are summarized as follows:

(amounts in millions)

Current assets [1]	$	6.4
Current liabilities		(10.4)

Property, plant and equipment	1.5
Other assets	7.4
Intangible assets	8.7
Goodwill[2]	11.8
Long-term liabilities	(4.5)
Fair value of net assets acquired, excluding cash position at acquisition	20.9
Cash position at acquisition	2.5
Total consideration	23.4

(1) Excluding cash on hand

(2) This goodwill is not deductible for tax purposes

The allocation of the purchase price is based on Management's best estimate of the fair value of assets and liabilities. Allocation involves a number of estimates as well as the gathering of information over a number of months. The allocation of the purchase price is preliminary and is expected to be completed in the near future. The net assets of Engenuity, excluding income taxes, will be included in both the Simulation Products/Military and Training & Services/Military segment.

MULTIGEN-PARADIGM INC.

In April 2007, the Company signed an agreement with Parallax Capital Partners, LLC and others to acquire MultiGen-Paradigm Inc., for approximately US$16 million in cash. The acquisition was completed in May 2007.

12. CONTROLS AND PROCEDURES

The external auditor reports regularly to management on any weaknesses it finds in our internal control and these reports are reviewed by the Audit Committee.

12.1 EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Our disclosure controls and procedures are designed to provide reasonable assurance that information is accumulated and communicated to our President and Chief Executive Officer (CEO) and Chief Financial Officer (CFO) and other members of management, so we can make timely decisions about required disclosure.

Under the supervision of the President and CEO and the CFO, management evaluated the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) and 15d-15(e) under the *U.S. Securities Exchange Act of 1934* , as of March 31, 2007. The President and CEO and the CFO concluded from the evaluation that the design and operation of our disclosure controls and procedures were effective as at March 31, 2007, and ensure that information is recorded, processed, summarized and reported within the time periods specified under Canadian and U.S. securities laws.

12.2 INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) and 15d-15(f) under the *U.S Securities Exchange Act of 1934* . Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting, and the preparation of financial statements for external purposes in accordance with GAAP. Management evaluated the design and operation of our internal controls over financial reporting as of March 31, 2007, based on the framework and criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission C OSO), and has concluded that our internal control over financial reporting is effective. Management did not identify any material weaknesses.

We implemented the first phase of our new ERP system in the TS/C segment and Management ensured that proper internal controls over financial reporting were established and maintained.

With the exception of the above mentioned, we did not make other changes to these controls this fiscal year that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

13. OVERSIGHT ROLE OF AUDIT COMMITTEE AND BOARD OF DIRECTORS

The Audit Committee reviews our annual MD&A and related consolidated financial statements with management and the external auditor and recommends them to the Board of Directors for their approval. Management and our internal auditor also provide the Audit Committee with regular reports assessing our internal controls and procedures for financial reporting. The external auditor reports regularly to management on any weaknesses it finds in our internal control, and these reports are reviewed by the Audit Committee.

14. ADDITIONAL INFORMATION

You will find additional information about CAE, including our most recent AIF, on our website at www.cae.com, or on SEDAR at www.sedar.com or on EDGAR at www.sec.gov.

15. SELECTED FINANCIAL INFORMATION

Selected annual information for the past five years

(unaudited – amounts in millions, except per share amounts)	**2007**	2006 Restated	2005 Restated	2004 Restated	2003
Revenue	**$ 1,250.7**	$ 1,107.2	$ 986.2	$ 938.4	$ 976.8
Earnings (loss) from continuing operations	**129.1**	69.6	(304.4)	45.5	113.9
Net earnings (loss)	**127.4**	63.6	(199.6)	62.1	117.2
Financial position:					
Total assets	**$ 1,956.2**	$ 1,716.1	$ 1,699.7	$ 2,308.7	$ 2,356.5
Total net debt	**133.0**	190.2	285.8	529.6	757.1
Per share:					
Basic earnings (loss) from continuing operations	**$ 0.51**	$ 0.28	$ (1.23)	$ 0.20	$ 0.52
Diluted earnings (loss) from continuing operations	**0.51**	0.28	(1.23)	0.19	0.52
Basic net earnings (loss)	**0.51**	0.25	(0.81)	0.27	0.53
Diluted net earnings (loss)	**0.50**	0.25	(0.81)	0.27	0.53
Dividends	**0.04**	0.04	0.10	0.12	0.12
Shareholders' equity	**3.30**	2.69	2.63	3.94	3.42

Selected quarterly information

(unaudited – amounts in millions except per share amounts)	Q1 Restated	Q2 Restated	Q3	Q4	Total
Fiscal 2007					
Revenue	**$ 301.8**	**280.4**	**331.2**	**337.3**	**1,250.7**
Earnings from continuing operations	**$ 33.0**	**31.3**	**29.7**	**35.1**	**129.1**
Basic earnings per share from continuing operations	**$ 0.13**	**0.12**	**0.12**	**0.14**	**0.51**
Diluted earnings per share from continuing operations	**$ 0.13**	**0.12**	**0.12**	**0.14**	**0.51**
Net earnings	**$ 32.4**	**31.0**	**29.7**	**34.3**	**127.4**
Basic earnings per share	**$ 0.13**	**0.12**	**0.12**	**0.14**	**0.51**
Diluted earnings per share	**$ 0.13**	**0.12**	**0.12**	**0.14**	**0.50**
Average number of shares outstanding (basic)	**250.8**	**251.0**	**251.2**	**251.4**	**251.1**
Average exchange rate, U.S. dollar to Canadian dollar	**$ 1.12**	**1.12**	**1.14**	**1.17**	**1.14**
Fiscal 2006 (Restated)					
Revenue	$ 266.0	280.3	276.6	284.3	1,107.2
Earnings from continuing operations	$ 20.1	17.6	17.3	14.6	69.6
Basic earnings per share from continuing operations	$ 0.08	0.07	0.07	0.06	0.28
Diluted earnings per share from continuing operations	$ 0.08	0.07	0.07	0.06	0.28
Net earnings	$ 20.1	16.9	17.4	9.2	63.6
Basic earnings per share	$ 0.08	0.07	0.07	0.04	0.25
Diluted earnings per share	$ 0.08	0.07	0.07	0.04	0.25
Average number of shares outstanding (basic)	248.8	249.8	250.2	250.5	249.8
Average exchange rate, U.S. dollar					

to Canadian dollar	$ 1.24	1.20	1.17	1.15	1.19
Fiscal 2005 (Restated)					
Revenue	$ 230.9	235.1	257.5	262.7	986.2
Earnings (loss) from continuing operations	$ 18.4	13.0	(345.4)	9.6	(304.4)
Basic earnings (loss) per share from continuing operations	$ 0.07	0.05	(1.40)	0.04	(1.23)
Diluted earnings (loss) per share from continuing operations	$ 0.07	0.05	(1.40)[1]	0.04	(1.23)
Net earnings (loss)	$ 23.8	14.2	(346.7)	109.1	(199.6)
Basic earnings (loss) per share	$ 0.10	0.06	(1.40)	0.44	(0.81)
Diluted earnings (loss) per share	$ 0.10	0.05	(1.40)	0.44	(0.81)
Average number of shares outstanding (basic)	246.7	246.8	247.0	247.8	247.1
Average exchange rate, U.S. dollar to Canadian dollar	$ 1.36	1.31	1.22	1.23	1.28

[1]The effect of stock options potentially exercisable on loss per share from continuing operations was anti-dilutive; therefore, basic and diluted loss per share from continuing are the same.

Selected segment information (annual)

(unaudited – amounts in millions except operating margin)	Simulation Products			Training & Services			Total		
	2007	2006 Restated	2005 Restated	**2007**	2006 Restated	2005 Restated	**2007**	2006 Restated	2005 Restated
Civil									
Revenue	**$ 348.1**	$ 257.0	$ 213.4	**$ 336.9**	$ 322.3	$ 306.8	**$ 685.0**	$ 579.3	$ 520.2
Segment operating income	**60.4**	29.9	7.8	**64.3**	57.1	39.8	**124.7**	87.0	47.6
Operating margins (%)	***17.4***	*11.6*	*3.7*	***19.1***	*17.7*	*13.0*	***18.2***	*15.0*	*9.2*
Military									
Revenue	**$ 357.5**	$ 327.4	$ 278.9	**$ 208.2**	$ 200.5	$ 187.1	**$ 565.7**	$ 527.9	$ 466.0
Segment operating income	**39.1**	27.0	26.5	**33.7**	18.7	20.8	**72.8**	45.7	47.3
Operating margins (%)	***10.9***	*8.2*	*9.5*	***16.2***	*9.3*	*11.1*	***12.9***	*8.7*	*10.2*
Total									
Revenue	**$ 705.6**	$ 584.4	$ 492.3	**$ 545.1**	$ 522.8	$ 493.9	**$ 1,250.7**	$ 1,107.2	$ 986.2
Segment operating income	**99.5**	56.9	34.3	**98.0**	75.8	60.6	**197.5**	132.7	94.9
Operating margins (%)	***14.1***	*9.7*	*7.0*	***18.0***	*14.5*	*12.3*	***15.8***	*12.0*	*9.6*
						Other	**(8.1)**	(28.7)	(467.8)
						EBIT	**$ 189.4**	$ 104.0	$ (372.9)

Selected segment information (fourth quarter ending March 31)

(unaudited – amounts in millions except operating margin)	Simulation Products		Training & Services		Total	
	2007	2006 Restated	**2007**	2006 Restated	**2007**	2006 Restated
Civil						
Revenue	**$ 97.6**	$ 78.0	**$ 91.7**	$ 81.1	**$ 189.3**	$ 159.1

Segment operating income	**15.3**	9.3	**21.3**	14.9	**36.6**	24.2
Operating margins (%)	***15.7***	*11.9*	***23.2***	*18.4*	***19.3***	*15.2*
Military						
Revenue	**$ 92.2**	$ 77.5	**$ 55.8**	$ 47.7	**$ 148.0**	$ 125.2
Segment operating income	**9.5**	6.8	**6.1**	3.2	**15.6**	10.0
Operating margins (%)	***10.3***	*8.8*	***10.9***	*6.7*	***10.5***	*8.0*
Total						
Revenue	**$ 189.8**	$ 155.5	**$ 147.5**	$ 128.8	**$ 337.3**	$ 284.3
Segment operating income	**24.8**	16.1	**27.4**	18.1	**52.2**	34.2
Operating margins (%)	***13.1***	*10.4*	***18.6***	*14.1*	***15.5***	*12.0*
				Other	**1.1**	(25.1)
				EBIT	**$ 53.3**	$ 9.1

PRICEWATERHOUSECOOPERS

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CONSENT OF INDEPENDENT AUDITORS

We hereby consent to the use in this Annual Report on Form 40-F of CAE Inc. for the year ended March 31, 2007, of our auditors' report dated May 30, 2007 relating to the financial statements, management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial, which appears in this Annual Report.

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 30, 2007 relating to the financial statements, management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial, which appears in this Annual Report.

PricewaterhouseCoopers LLP

Chartered Accountants

Montreal, Quebec
June 28, 2007

PricewaterhouseCoopers refers to the Canadian firm of PricewaterhouseCoopers LLP/s.r.l./s.e.n.c.r.l. and the other member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

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Independent Auditors' Report

To the Shareholders of CAE Inc.:

We have completed an integrated audit of the 2007 consolidated financial statements and internal control over financial reporting of CAE Inc. (the "Company") as of March 31, 2007 and audits of its 2006 and 2005 consolidated financial statements. Our opinions, based on our audits, are presented below.

Consolidated financial statements

We have audited the accompanying consolidated balance sheets of the Company as of March 31, 2007 and 2006, and the related consolidated statements of earnings, retained earnings and cash flows for each of the three years in the period ended March 31, 2007. These consolidated 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 audit of the Company's financial statements as of March 31, 2007 and for the year then ended in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). We conducted our audits of the Company's financial statements as of March 31, 2006 and for each of the two years in the period ended March 31, 2006 in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance about 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. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of March 31, 2007 and 2006 and the results of its operations and its cash flows for each of the three years in the period ended March 31, 2007 in accordance with Canadian generally accepted accounting principles.

As described in note 1 to the consolidated financial statements, the Company has changed its accounting for stock-based compensation.

Internal control over financial reporting

We have also audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that the Company maintained effective internal control over financial reporting as of March 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal

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control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A

company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of March 31, 2007 is fairly stated, in all material respects, based on criteria established in *Internal Control – Integrated Framework* issued by the COSO. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2007 based on criteria established in *Internal Control – Integrated Framework* issued by the COSO.

PricewaterhouseCoopers LLP

Chartered Accountants

May 30, 2007
Montreal, Quebec, Canada

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

I, Robert E. Brown 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) 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

   (d) 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

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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: June 29, 2007

/s/ Robert E. Brown

Name: Robert E. Brown

Title:President and Chief Executive Officer

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

I, Alain Raquepas 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) 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

   (d) 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

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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: June 29, 2007

/s/ Alain Raquepas

Name: Alain Raquepas
Title:Vice President, Finance and
Chief Financial Officer

CERTIFICATION REQUIRED BY 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, 2007 (the "Report").

I, Robert E. Brown, 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.

/s/ Robert E. Brown

Robert E. Brown
President and Chief Executive
Officer

Date: June 29, 2007

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, 2007 (the "Report").

I, Alain Raquepas, Vice President, Finance and Chief Financial 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.

/s/ Alain Raquepas

Alain Raquepas
Vice President, Finance and Chief Financial Officer

Date: June 29, 2007