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Management's Discussion and Analysis

for the three months ended September 30, 2018

1. HIGHLIGHTS

RESTATEMENT OF COMPARATIVES

Effective April 1, 2018 we implemented IFRS 15, *Revenue from contracts with customers*. Comparative figures provided for each quarter of the year ended March 31, 2018 have been restated to reflect the adoption of this accounting standard. The adjustments to our consolidated statements of financial position and income statement as a result of the adoption of IFRS 15 are discussed further in *Changes in accounting policies*.

FINANCIAL

SECOND QUARTER OF FISCAL 2019

<i>(amounts in millions, except per share amounts, ROCE and book-to-sales)</i>	Q2-2019	Q2-2018	Variance \$	Variance %
Income Statement				
Revenue	\$ 743.8	\$ 618.2	\$ 125.6	20 %
Segment operating income (SOI) ¹	\$ 98.7	\$ 102.8	\$ (4.1)	(4 %)
SOI before the impact of the net gain on a strategic transaction related to our Asian joint venture	\$ 98.7	\$ 88.5	\$ 10.2	12 %
Net income attributable to equity holders of the Company	\$ 60.7	\$ 60.3	\$ 0.4	1 %
Basic and diluted earnings per share	\$ 0.23	\$ 0.22	\$ 0.01	5 %
Earnings per share before the impact of the net gain on a strategic transaction related to our Asian joint venture	\$ 0.23	\$ 0.20	\$ 0.03	15 %
Cash Flows				
Free cash flow ¹	\$ 137.7	\$ 63.5	\$ 74.2	117 %
Net cash provided by operating activities	\$ 177.1	\$ 97.1	\$ 80.0	82 %
Financial Position				
Capital employed ¹	\$ 3,077.7	\$ 2,706.2	\$ 371.5	14 %
Non-cash working capital ¹	\$ 182.6	\$ 178.5	\$ 4.1	2 %
Net debt ¹	\$ 795.1	\$ 669.8	\$ 125.3	19 %
Return on capital employed (ROCE) ¹	% 14.5	% 11.1		
ROCE before the impacts of U.S. tax reform and net gains on strategic transactions related to our Asian joint ventures	% 12.8	% 10.8		
Backlog				
Total backlog ¹	\$ 8,667.6	\$ 7,004.3	\$ 1,663.3	24 %
Order intake ¹	\$ 985.9	\$ 931.4	\$ 54.5	6 %
Book-to-sales ratio ¹	1.33	1.51		
Book-to-sales ratio for the last 12 months	1.30			

FISCAL 2019 YEAR TO DATE

<i>(amounts in millions, except per share amounts)</i>	Q2-2019	Q2-2018	Variance \$	Variance %
Income Statement				
Revenue	\$ 1,465.8	\$ 1,274.4	\$ 191.4	15 %
Segment operating income	\$ 197.2	\$ 194.1	\$ 3.1	2 %
SOI before the impact of the net gain on a strategic transaction related to our Asian joint venture	\$ 197.2	\$ 179.8	\$ 17.4	10 %
Net income attributable to equity holders of the Company	\$ 130.1	\$ 119.9	\$ 10.2	9 %
Basic earnings per share	\$ 0.49	\$ 0.45	\$ 0.04	9 %
Diluted earnings per share	\$ 0.48	\$ 0.44	\$ 0.04	9 %
Earnings per share before the impact of the net gain on a strategic transaction related to our Asian joint venture	\$ 0.48	\$ 0.42	\$ 0.06	14 %
Cash Flows				
Free cash flow	\$ 51.9	\$ 25.6	\$ 26.3	103 %
Net cash provided by operating activities	\$ 146.5	\$ 77.9	\$ 68.6	88 %

¹ Non-GAAP and other financial measures (see Section 5).

BUSINESS COMBINATION

- On July 31, 2018, we acquired the shares of Alpha-Omega Change Engineering Inc. (AOCE), a provider of aircrew training services, operational test and evaluation, and engineering support services to the U.S. Department of Defense and U.S. intelligence service.

OTHER

- In July, subsequent to a five-week work stoppage of manufacturing employees, we renewed our collective bargaining agreement for the employee group in Montreal, Canada for a four-year term with a one year option;
- We announced a plan to invest \$1 billion in R&D innovation over the next 5 years, including Project Digital Intelligence. The goal of Project Digital Intelligence is to develop the next generation training solutions for aviation, defence and security and healthcare to leverage digital technologies. The Governments of Canada and Québec have agreed to participate in Project Digital Intelligence through partially repayable investments of \$150.0 million and \$47.5 million, respectively.

EVENT AFTER THE REPORTING PERIOD

- On November 8, 2018, we announced that we have agreed to acquire Bombardier's Business Aircraft Training (BAT) business for a consideration of US \$645 million, before liabilities assumed. In addition, we have agreed to pay US \$155 million to Bombardier to monetize our future royalty obligations under the current Authorized Training Provider (ATP) agreement, and extend this agreement with Bombardier to 2038.

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 2019* mean the fiscal year ending March 31, 2019;
- *Last year, prior year and a year ago* mean the fiscal year ended March 31, 2018;
- Dollar amounts are in Canadian dollars.

This report was prepared as of November 13, 2018, and includes our management's discussion and analysis (MD&A), unaudited consolidated interim financial statements and notes for the second quarter ended September 30, 2018. We have prepared it to help you understand our business, performance and financial condition for the second quarter of fiscal 2019. Except as otherwise indicated, all financial information has been reported in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board, and based on unaudited figures.

For additional information, please refer to our unaudited consolidated interim financial statements for the quarter ended September 30, 2018, and our annual audited consolidated financial statements, which you will find in our financial report for the year ended March 31, 2018. The MD&A section of our 2018 financial report also 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 mission;
- Our vision;
- Our strategy;
- Our operations;
- Foreign exchange;
- Non-GAAP and other financial measures;
- Consolidated results;
- Results by segment;
- Consolidated cash movements and liquidity;
- Consolidated financial position;
- Business combinations;
- Business risk and uncertainty;
- Related party transactions;
- Changes in accounting policies;
- Controls and procedures;
- Oversight role of the Audit Committee and Board of Directors.

You will find our most recent financial 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. Holders of CAE's securities may also request a printed copy of the Company's consolidated financial statements and MD&A free of charge by contacting Investor Relations (investor.relations@cae.com).

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.

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

This report includes forward-looking statements about our activities, events and developments that we expect to or anticipate may occur in the future including, for example, statements about our vision, strategies, market trends and outlook, future revenues, capital spending, expansions and new initiatives, financial obligations and expected sales. Forward-looking statements normally contain words like *believe*, *expect*, *anticipate*, *plan*, *intend*, *continue*, *estimate*, *may*, *will*, *should*, *strategy*, *future* and similar expressions. By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties associated with our business which may cause actual results in future periods to differ materially from results indicated in forward-looking statements. While these statements are based on management's expectations and assumptions regarding historical trends, current conditions and expected future developments, as well as other factors that we believe are reasonable and appropriate in the circumstances, readers are cautioned not to place undue reliance on these forward-looking statements as there is a risk that they may not be accurate.

Important risks that could cause such differences include, but are not limited to, risks relating to the industry such as competition, level and timing of defence spending, government-funded defence and security programs, constraints within the civil aviation industry, regulatory rules and compliance, risks relating to CAE such as product evolution, research and development activities, fixed-price and long-term supply contracts, strategic partnerships and long-term contracts, procurement and original equipment manufacturer (OEM) leverage, warranty or other product-related claims, product integration and program management, protection of our intellectual property, third-party intellectual property, loss of key personnel, labour relations, environmental matters, claims arising from casualty losses, integration of acquired businesses, our ability to penetrate new markets, U.S. foreign ownership, control or influence mitigation measures, length of sales cycle, seasonality, continued returns to shareholders, information technology systems including cybersecurity risk, data privacy risk and our reliance on technology and third-party providers and risks relating to the market such as foreign exchange, availability of capital, pension plan funding, doing business in foreign countries including corruption risk, political instability and income tax laws. Additionally, differences could arise because of events announced or completed after the date of this report. You will find more information about the risks and uncertainties affecting our business in our 2018 financial report. We caution readers that the risks described above are not necessarily the only ones we face; additional risks and uncertainties that are presently unknown to us or that we may currently deem immaterial may adversely affect our business.

Except as required by law, we disclaim any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise. The forward-looking information and statements contained in this report are expressly qualified by this cautionary statement.

3. ABOUT CAE

3.1 Who we are

CAE is a global leader in training for the civil aviation, defence and security, and healthcare markets. Backed by a record of more than 70 years of industry firsts, we continue to help define global training standards with our innovative virtual-to-live training solutions to make flying safer, maintain defence force readiness and enhance patient safety. We have the broadest global presence in the industry, with over 9,000 employees, 160 sites and training locations in over 35 countries. Each year, we train more than 180,000 civil and defence crewmembers, including more than 135,000 pilots, and thousands of healthcare professionals worldwide.

CAE's common shares are listed on the Toronto and New York stock exchanges under the symbol CAE.

3.2 Our mission

Through the training we provide, our mission is to make air travel safer, defence forces mission ready and medical personnel better able to save lives.

3.3 Our vision

Our vision is to be the recognized global training partner of choice to enhance safety, efficiency and readiness.

3.4 Our strategy

We address safety, efficiency and readiness for customers in three core markets: civil aviation, defence and security, and healthcare.

We are a unique, pure-play training company with a proven record, of more than 70 years, of commitment to our customers' long-term training needs.

We offer the most innovative and broadest range of comprehensive training solutions across a global network by incorporating a combination of live training on actual platforms, virtual training in simulators and extended reality applications, and constructive training using computer-generated simulations. Our strategic imperatives focus on the protection of our leadership position and growing at a superior rate than the underlying markets.

Six pillars of strength

We believe there are six fundamental strengths that underpin our strategy and position us well for sustainable long-term growth:

- High degree of recurring business;
- Strong competitive moat;
- Headroom in large markets;
- Underlying secular tailwinds;
- Potential for superior returns;
- Culture of innovation.

High degree of recurring business

We operate in highly regulated industries with mandatory and recurring training requirements for maintaining professional certifications. Approximately 60% of our business is derived from the provision of services, which is an important source of our recurring business, and largely involves long-term agreements with many airlines, business aircraft operators and defence forces.

Strong competitive moat

Our global training network, unique end-to-end cadet to captain training solutions, digitally-enabled training systems, training systems integrator expertise, unrivaled customer intimacy and strong, recognizable brand further strengthen our competitive moat.

Headroom in large markets

We provide innovative training solutions to customers in large addressable markets in civil aviation, defence and security and healthcare. Significant untapped market opportunities exist in these three core businesses, with substantial headroom to grow our market share over the long-term.

Underlying secular tailwinds

The civil aviation and defence sectors are enjoying strong tailwinds. Air passenger traffic and defence budgets are expected to continue to increase globally over the next 10 years.

Potential for superior returns

Our rising proportion of revenue from training services provides potential for lower amplitude cyclicality as training is largely driven by the training requirements of the installed fleet. In addition, we leverage our leading market position to deepen and expand our customer relationships. We see opportunity to further utilize our training network and generate more revenue from existing assets and to deploy new assets with accretive returns.

Culture of innovation

We derive significant competitive advantage as an innovative leader in simulation products and training solutions. In collaboration with our customers, we design and deliver the industry's most sophisticated training systems, employing the latest in simulation, extended reality and digital technologies, which are shaping the future of training.

3.5 Our operations

We provide integrated training solutions to three markets globally:

- The civil aviation market includes major commercial airlines, regional airlines, business aircraft operators, civil helicopter operators, aircraft manufacturers, third-party training centres, flight training organizations, maintenance repair and overhaul organizations (MROs) and aircraft finance leasing companies;
- The defence and security market includes defence forces, OEMs, government agencies and public safety organizations worldwide;
- The healthcare market includes hospital and university simulation centres, medical and nursing schools, paramedic organizations, defence forces, medical societies and OEMs.

CIVIL AVIATION MARKET

We provide comprehensive training solutions for flight, cabin, maintenance and ground personnel in commercial, business and helicopter aviation, a complete range of flight simulation training devices, as well as ab initio pilot training and crew sourcing services.

We have the unique capability and global scale to address the total lifecycle needs of the professional pilot, from cadet to captain, with our comprehensive aviation training solutions. We are the world's largest provider of commercial aviation training services and the second largest in business aviation training services. Our deep industry experience and thought leadership, large installed base, strong relationships and reputation as a trusted partner, enable us to access a broader share of the market than any other company in our industry. We provide aviation training services in more than 30 countries and through our broad global network of more than 50 training centres, we serve all sectors of civil aviation including airlines and other commercial, business and helicopter aviation operators.

Among our thousands of customers, we have long-term training centre operations and training services agreements and joint ventures with approximately 40 major airlines and aircraft operators around the world. Our range of training solutions includes products and services offerings for pilot, cabin crew and aircraft maintenance technician training, training centre operations, curriculum development, courseware solutions and consulting services. We currently operate 264 full-flight simulators (FFSs), including those operating in our joint ventures. We offer industry-leading technology, and we are shaping the future of training through innovations such as our next generation training systems, including CAE Real-time Insights and Standardized Evaluations (CAE Rise™), which improves training quality, objectivity and efficiency through the integration of untapped flight and simulator data-driven insights into training. In the formation of new pilots, CAE operates the largest ab initio flight training network in the world. In resource management, CAE is the global market leader in the provision of flight crew and technical personnel to airlines, aircraft leasing companies, manufacturers and MRO companies worldwide.

Quality, fidelity, reliability and innovation are hallmarks of the CAE brand in flight simulation and we are the world leader in the development of civil flight simulators. We continuously innovate our processes and lead the market in the design, manufacture and integration of civil FFSs for major and regional commercial airlines, third-party training centres and OEMs. We have established a wealth of experience in developing first-to-market simulators for more than 35 types of aircraft models. Our flight simulation equipment, including FFSs, are designed to meet the rigorous demands of their long and active service lives, often spanning several decades of continuous use. Our global reach enables us to provide best-in-class support services such as real-time, remote monitoring and also enables us to leverage our extensive worldwide network of spare parts and service teams.

Demand for trained aviation professionals is driven by air traffic growth, pilot retirements and the increase in active aircraft fleets. As the global economies and airline fleets continue to expand, so does the demand for qualified airline personnel and, in turn, demand for comprehensive training solutions.

- In commercial aviation, the aerospace industry's widely held expectation is that long-term average growth for air travel will continue at 3.5% annually over the next decade. For the first nine months of calendar 2018, passenger traffic increased by 6.7% compared to the first nine months of calendar 2017. Passenger traffic in Asia grew by 9.2% while Europe, Latin America, North America and the Middle East increased by 6.2%, 6.1%, 5.1% and 4.6% respectively;
- In business aviation, training demand is closely aligned to business jet travel. According to the Federal Aviation Administration (FAA), the total number of business jet flights, which includes all domestic and international flights, was up with 2.2% growth over the past 12 months. Similarly, according to Eurocontrol, the European Organisation for the Safety of Air Navigation, the total number of business aviation flights in Europe has improved by 2.3%;
- The global active commercial aircraft fleet is widely expected to grow at an approximate average rate of 3.5% annually over the next two decades. From September 2017 to September 2018, the global commercial aircraft fleet increased by 4.2%, growing by 6.3% in Asia Pacific, 4.2% in Europe, the Middle East and Africa and by 2.5% in the Americas.

Market drivers

Demand for training solutions in the civil aviation market is driven by the following:

- Pilot training and certification regulations;
- Safety and efficiency imperatives of commercial airline and business aircraft operators;
- Expected long-term global growth in air travel;
- Growing active fleet of commercial and business aircraft;
- Demand for trained aviation professionals.

DEFENCE AND SECURITY MARKET

We are a training systems integrator for defence forces across the air, land and naval domains, and for government organizations responsible for public safety.

We are a global leader in the development and delivery of integrated live, virtual and constructive (iLVC) training solutions for defence forces. Most militaries leverage a combination of live training on actual platforms, virtual training in simulators, and constructive training using computer-generated simulations. CAE is skilled and experienced as a training systems integrator capable of helping defence forces achieve an optimal balance of iLVC training to achieve mission readiness. Our expertise in training spans a broad variety of aircraft, including fighters, helicopters, trainer aircraft, maritime patrol, tanker/transport aircraft and remotely piloted aircraft, also called unmanned aerial systems. Increasingly, we are leveraging our training systems integration capabilities in the naval domain to provide naval training solutions, as evidenced by the program to provide the United Arab Emirates (UAE) Navy with a comprehensive Naval Training Centre. We offer training solutions for land forces, including a range of driver, gunnery and maintenance trainers for tanks and armoured fighting vehicles as well as constructive simulation for command and staff training. We also offer training solutions to government organizations for emergency and disaster management. In fiscal 2018, we established CAE USA Mission Solutions Inc., a subsidiary of CAE USA that operates under a Proxy Agreement with the U.S. government and enables CAE USA Mission Solutions Inc. to pursue and execute higher-level security programs.

Defence forces seek to increasingly leverage virtual training and balance their training approach between live, virtual and constructive domains to achieve maximum readiness and efficiency. As such, we have been increasingly pursuing programs requiring the integration of live, virtual and constructive training and these tend to be larger in size than programs involving only a single component of such a solution. We are a first-tier training systems integrator and uniquely positioned to offer our customers a comprehensive range of innovative iLVC solutions, ranging from academic, virtual and live training to immersive, networked mission rehearsal in a synthetic environment. Our solutions typically include a combination of training services, products and software tools designed to cost-effectively maintain and enhance safety, efficiency, mission readiness and decision-making capabilities. We have a wealth of experience delivering and operating outsourced training solutions across different business models, including government-owned government-operated; government-owned contractor-operated; or contractor-owned contractor-operated facilities. Our offerings include training needs analysis; instructional systems design; learning management information systems; purpose-built facilities; state-of-the-art synthetic training equipment; curriculum and courseware development; classroom, simulator, and live flying instruction; maintenance and logistics support; lifecycle support and technology insertion; and financing alternatives.

We have delivered simulation products and training systems to approximately 50 defence forces in over 35 countries. We provide training support services such as contractor logistics support, maintenance services, classroom instruction and simulator training at over 90 sites around the world, including our joint venture operations. We continue to increase our support for live flying training, such as the live training delivered as part of the NATO Flying Training in Canada and the U.S. Army Fixed-Wing Flight Training programs, as we help our customers achieve an optimal balance across their training enterprise.

Market drivers

Demand for training solutions in the defence and security markets is driven by the following:

- Growing defence budgets;
- Attractiveness of outsourcing training and maintenance services;
- Desire to integrate training systems to achieve efficiencies and enhanced preparedness;
- Need for synthetic training to conduct integrated, networked mission training, including joint and coalition forces training;
- Explicit desire of governments and defence forces to increase the use of synthetic training;
- Installed base of enduring defence platforms and new customers;
- Relationships with OEMs for simulation and training.

HEALTHCARE MARKET

We design and manufacture simulators, audiovisual and simulation centre management solutions, develop courseware and offer services for training of medical, nursing and allied healthcare students as well as healthcare providers worldwide.

Simulation-based training is one of the most effective approaches to prepare healthcare practitioners to care for patients and respond to critical situations while reducing medical errors. We are leveraging our experience and best practices in simulation-based aviation training to deliver innovative solutions to improve the safety and efficiency in the delivery of patient care. The healthcare simulation market is expanding, with simulation centres becoming increasingly more prevalent in nursing and medical schools.

We offer the broadest range and most innovative portfolio of medical simulation products and services in the market today, including patient, ultrasound and interventional (surgical) simulators, audiovisual and simulation centre management solutions as well as courseware for simulation-based healthcare education and training. We have sold simulators to customers in approximately 90 countries that are currently supported by our global network. We are a leader in high-fidelity patient simulators that are uniquely powered by advanced models of human physiology to realistically mimic human responses to clinical interventions. For example, our high-fidelity childbirth simulator, Lucina, was designed to offer exceptional realism for simulated scenarios of both normal deliveries and rare maternal emergencies. Last year, we introduced the CAE Juno clinical skills manikin for nurse education which allows nursing programs to adapt to new realities of more complex conditions of hospital patients, liability concerns in healthcare, and thus, decreased access to live patients for learners. In June of this year, we announced the launch of our new CAE Ares emergency care manikin that was designed for advanced life support and American Heart Association (AHA) training. With the introduction of two mid-fidelity manikins, we are now providing more innovative learning tools to healthcare academic institutes, being the largest segment in the healthcare simulation market. We were the first to bring a commercial Microsoft HoloLens mixed reality application to the medical simulation market, and we continue to integrate augmented and virtual reality into our advanced software platforms to deliver custom training solutions and ground-breaking products.

Through our Healthcare Academy, we deliver peer-to-peer training at customer sites as well as in our training centres in the U.S., U.K., Germany and Canada. Our Healthcare Academy includes more than 50 adjunct faculty consisting of nurses, physicians, paramedics and sonographers who, in collaboration with leading healthcare institutions, have developed more than 500 Simulated Clinical Experience courseware packages for our customers.

We offer turnkey solutions, project management and professional services for healthcare simulation programs. We also collaborate with medical device companies and scientific societies to develop innovative and custom training solutions. Since September 2017, in collaboration with the American Society of Anesthesiologists (ASA), we have released the first three modules for Anesthesia SimSTAT, a virtual healthcare training environment for practicing physicians. This new platform provides continuing medical education for Maintenance of Certification in Anesthesiology (MOCA) and has allowed us to expand access to simulation-based clinical training among the anesthesia community. Furthermore, through industry partnerships with medical device companies, we have developed a specialized interventional simulator to train physicians to implant a new generation of pacemakers as well as a modular, portable cath lab interventional simulator, CAE CathLabVR, which was introduced to the cardiac simulation community in September 2018. In January 2018, we announced that in collaboration with the AHA, we will establish a network of International Training Sites to deliver lifesaving AHA courses in countries that are currently underserved. The first authorized site operated by CAE Healthcare has opened within the CAE Brunei Multi-Purpose Training Centre in Brunei Darussalam.

Market drivers

Demand for our simulation products and services in the healthcare market is driven by the following:

- Limited access to live patients during training;
- Medical technology revolution;
- Broader adoption of simulation, with a demand for innovative and custom training approaches;
- Growing emphasis on patient safety and outcomes.

You will find more information about our operations in our 2018 financial report, AIF or our Annual Activity and Corporate Social Responsibility Report.

4. FOREIGN EXCHANGE

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

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

We used the closing foreign exchange rates below to value our assets, liabilities and backlog in Canadian dollars at the end of each of the following periods:

	September 30	June 30	Increase /	March 31	Increase /
	2018	2018	(decrease)	2018	(decrease)
U.S. dollar (US\$ or USD)	1.29	1.32	(2 %)	1.29	— %
Euro (€ or EUR)	1.50	1.53	(2 %)	1.59	(6 %)
British pound (£ or GBP)	1.69	1.73	(2 %)	1.81	(7 %)

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

	September 30	June 30	Increase /	September 30	Increase /
	2018	2018	(decrease)	2017	(decrease)
U.S. dollar (US\$ or USD)	1.31	1.29	2 %	1.26	4 %
Euro (€ or EUR)	1.52	1.54	(1 %)	1.47	3 %
British pound (£ or GBP)	1.71	1.76	(3 %)	1.64	4 %

The effect of translating the results of our foreign operations into Canadian dollars resulted in an increase in this quarter's revenue of \$16.8 million and an increase in net income of \$2.1 million when compared to the second quarter of fiscal 2018. For the first six months of fiscal 2019, the effect of translating the results of our foreign operations into Canadian dollars resulted in an increase in revenue of \$11.7 million and an increase in net income of \$1.6 million when compared to the first six months of fiscal 2018. We calculated this by translating the current quarter foreign currency revenue and net income using the average monthly exchange rates from the prior year's second quarter and comparing these adjusted amounts to our current quarter reported results.

5. 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. These measures should not be confused with, or used as an alternative for, performance measures calculated according to GAAP. Furthermore, these non-GAAP measures should not be compared with similarly titled measures provided or used by other companies.

Capital employed

Capital employed

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

Capital used:

- For the Company as a whole, we take total assets (not including cash and cash equivalents), and subtract total liabilities (not including long-term debt and the current portion of long-term debt);
- 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 the current portion of long-term debt, royalty obligations, employee benefit obligations and other non-operating liabilities).

Source of capital:

- In order to understand our source of capital, we add net debt to total equity.

Return on capital employed (ROCE)

ROCE is used to evaluate the profitability of our invested capital. We calculate this ratio over a rolling four-quarter period by taking net income attributable to equity holders of the Company excluding net finance expense, after tax, divided by the average capital employed.

Capital expenditures (maintenance and growth) from property, plant and equipment

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

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

Earnings per share (EPS) before specific items

Earnings per share before specific items is a non-GAAP measure calculated by excluding the effect of restructuring, integration and acquisition costs and one-time tax items from the diluted earnings per share from continuing operations attributable to equity holders of the Company. The effect per share is obtained by dividing the restructuring, integration and acquisition costs, net of tax, and one-time tax items by the average number of diluted shares. We track it because we believe it provides a better indication of our operating performance on a per share basis and makes it easier to compare across reporting periods.

Free cash flow

Free cash flow is a non-GAAP measure that shows us how much cash we have available to invest in growth opportunities, repay debt and meet ongoing financial obligations. We use it as an indicator of our financial strength and liquidity. We calculate it by taking the net cash generated by our continuing operating activities, subtracting maintenance capital expenditures, investment in other assets not related to growth and dividends paid and adding proceeds from the disposal of property, plant and equipment, dividends received from equity accounted investees and proceeds, net of payments, from equity accounted investees.

Gross profit

Gross profit is a non-GAAP measure equivalent to the operating profit excluding research and development expenses, selling, general and administrative expenses, other (gains) losses – net, after tax share in profit of equity accounted investees and restructuring, integration and acquisition costs. We believe it is useful to management and investors in evaluating our ongoing operational performance.

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, including the current portion of long-term debt, and subtracting cash and cash equivalents.

Net debt-to-capital is calculated as net debt divided by the sum of total equity plus net debt.

Non-cash working capital

Non-cash working capital is a non-GAAP measure we use to monitor how much money we have committed in the day-to-day operation of our business. We calculate it by taking current assets (not including cash and cash equivalents and assets held for sale) and subtracting current liabilities (not including the current portion of long-term debt and liabilities held for sale).

Operating profit

Operating profit is an additional GAAP measure that shows us how we have performed before the effects of certain financing decisions, tax structures and discontinued operations. We track it 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.

Order intake and Backlog*Order intake*

Order intake is a non-GAAP measure that represents the expected value of orders we have received.

- For the Civil Aviation Training Solutions segment, we consider an item part of our order intake 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. Additionally, expected future revenues from customers under short-term and long-term training contracts are included when these customers commit to pay us training fees, or when we reasonably expect the revenue to be generated;
- For the Defence and Security segment, we consider an item part of our order intake 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. Defence and Security contracts are usually executed over a long-term period but some of them must be renewed each year. For this segment, we only include a contract item in order intake when the customer has authorized the contract item and has received funding for it;
- For the Healthcare segment, order intake is typically converted into revenue within one year, therefore we assume that order intake is equal to revenue.

The book-to-sales ratio is the total orders divided by total revenue in a given period.

Backlog

Total backlog is a non-GAAP measure that represents expected future revenues and includes obligated backlog, joint venture backlog and unfunded backlog and options.

- Obligated backlog represents the value of our order intake not yet executed and is calculated by adding the order intake of the current period to the balance of the obligated backlog at the end of the previous fiscal year, subtracting the revenue recognized in the current period and adding or subtracting backlog adjustments. If the amount of an order already recognized in a previous fiscal year is modified, the backlog is revised through adjustments;
- Joint venture backlog is obligated backlog that represents the expected value of our share of orders that our joint ventures have received but have not yet executed. Joint venture backlog is determined on the same basis as obligated backlog described above;
- Unfunded backlog represents firm Defence and Security orders we have received but have not yet executed and for which funding authorization has not yet been obtained. Options are included in backlog when there is a high probability of being exercised, but indefinite-delivery/indefinite-quantity contracts are excluded. When an option is exercised, it is considered order intake in that period and it is removed from unfunded backlog and options.

Research and development expenses

Research and development expenses are a financial measure we use to measure the amount of expenditures directly attributable to research and development activities that we have expensed during the period, net of investment tax credits and government contributions.

Simulator equivalent unit (SEU)

SEU is an operating measure we use to show the total average number of FFSs available to generate earnings 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 SEU. If a FFS is being powered down and relocated, it will not be included as a SEU until the FFS is re-installed and available to generate earnings.

Total segment operating income (SOI)

Total segment operating income is a non-GAAP measure and is the sum of our key indicator of each segment's financial performance. Segment operating income gives us an indication of the profitability of each segment because it does not include the impact of any items not specifically related to the segment's performance. We calculate total segment operating income by taking the operating profit and excluding the impact of restructuring, integration and acquisition costs.

Utilization rate

Utilization rate is one of the operating measures we use to assess the performance of our Civil simulator training network. While utilization rate does not perfectly correlate to revenue recognized, we track it, together with other measures, because we believe it is an indicator of our operating performance. We calculate it by taking the number of training hours sold on our simulators during the period divided by the practical training capacity available for the same period.

6. CONSOLIDATED RESULTS

6.1 Results from operations – second quarter of fiscal 2019

<i>(amounts in millions, except per share amounts)</i>	Q2-2019	Q1-2019	Q4-2018	Q3-2018	Q2-2018
Revenue	\$ 743.8	722.0	720.9	828.2	618.2
Cost of sales	\$ 542.3	503.3	483.9	572.5	436.7
Gross profit ²	\$ 201.5	218.7	237.0	255.7	181.5
<i>As a % of revenue</i>	% 27.1	30.3	32.9	30.9	29.4
Research and development expenses ²	\$ 29.1	31.3	22.8	29.8	30.0
Selling, general and administrative expenses	\$ 87.9	102.7	112.3	98.6	75.1
Other gains – net	\$ (9.4)	(5.2)	(4.3)	(15.1)	(18.3)
After tax share in profit of equity accounted investees	\$ (4.8)	(8.6)	(11.3)	(8.8)	(8.1)
Operating profit ²	\$ 98.7	98.5	117.5	151.2	102.8
<i>As a % of revenue</i>	% 13.3	13.6	16.3	18.3	16.6
Finance expense – net	\$ 19.9	16.0	24.2	17.2	17.6
Earnings before income taxes	\$ 78.8	82.5	93.3	134.0	85.2
Income tax expense (recovery)	\$ 15.2	10.9	7.7	(11.8)	23.1
<i>As a % of earnings before income taxes (income tax rate)</i>	% 19	13	8	(9)	27
Net income	\$ 63.6	71.6	85.6	145.8	62.1
Attributable to:					
Equity holders of the Company	\$ 60.7	69.4	82.3	143.8	60.3
Non-controlling interests	\$ 2.9	2.2	3.3	2.0	1.8
	\$ 63.6	71.6	85.6	145.8	62.1
EPS attributable to equity holders of the Company					
Basic	\$ 0.23	0.26	0.31	0.54	0.22
Diluted	\$ 0.23	0.26	0.31	0.53	0.22
Before U.S. tax reform and net gains on strategic transactions related to our Asian joint ventures	\$ 0.23	0.26	0.31	0.38	0.20

Revenue was 20% higher than the second quarter of fiscal 2018

Revenue was \$125.6 million higher than the second quarter of fiscal 2018. Increases in revenue were \$75.2 million, \$48.3 million and \$2.1 million for Civil Aviation Training Solutions, Defence and Security and Healthcare respectively.

For the first six months of fiscal 2019, revenue was \$191.4 million higher than the same period last year. Increases in revenue were \$134.5 million, \$55.9 million and \$1.0 million for Civil Aviation Training Solutions, Defence and Security and Healthcare respectively.

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

Total segment operating income² was \$4.1 million lower compared to the second quarter of fiscal 2018

Total segment operating income this quarter was \$98.7 million, or 13.3% of revenue, compared to \$102.8 million or 16.6% of revenue in the second quarter of fiscal 2018. In fiscal 2018, we entered into a strategic joint venture transaction, which resulted in a gain from the disposal of our equity interest in Zhuhai Xiang Yi Aviation Technology Company Limited (ZFTC) in the second quarter. Excluding this gain, segment operating income would have been \$88.5 million or 14.3% of revenue in the second quarter of fiscal 2018.

Total segment operating income was \$4.1 million or 4% lower compared to the second quarter of fiscal 2018. Decreases in segment operating income were \$4.0 million and \$0.9 million for Civil Aviation Training Solutions and Healthcare respectively, partially offset by an increase of and \$0.8 million for Defence and Security.

² Non-GAAP and other financial measures (see Section 5).

For the first six months of fiscal 2019, total segment operating income was \$197.2 million, or 13.5% of revenue, compared to \$194.1 million, or 15.2% of revenue for the same period last year. Excluding the gain from the disposal of ZFTC, segment operating income would have been \$179.8 million or 14.1% of revenue for the first six months of fiscal 2018.

For the first six months of fiscal 2019, total segment operating income was \$3.1 million or 2% higher compared to the same period last year resulting from an increase of \$5.4 million for Civil Aviation Training Solutions, partially offset by decreases of \$1.7 million and \$0.6 million for Defence and Security and Healthcare respectively.

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

Net finance expense was \$2.3 million higher than the second quarter of fiscal 2018

The increase compared to the second quarter of fiscal 2018 was mainly due to higher interest on long-term debt and higher finance expense on royalty obligations.

For the first six months of fiscal 2019 net finance expense was \$35.9 million, \$0.1 million higher compared to the same period last year.

Income tax rate was 19% this quarter

Income taxes this quarter were \$15.2 million, representing an effective tax rate of 19% compared to 27% for the second quarter of fiscal 2018.

The reduction in the tax rate compared to the second quarter of fiscal 2018 was mainly due to the sale of our equity interest in the joint venture ZFTC and a negative impact from tax audits in Canada last year, partially offset by a change in the mix of income from various jurisdictions.

For the first six months of fiscal 2019, income taxes were \$26.1 million, representing an effective tax rate of 16% compared to 22% for the same period last year.

The lower tax rate for the first six months of fiscal 2019, compared to the same period last year, was mainly due to the sale of our equity interest in the joint venture ZFTC and the impact from tax audits in Canada, partially offset by a change in the mix of income from various jurisdictions.

6.2 Consolidated orders and total backlog

Total backlog stable compared to last quarter

<i>(amounts in millions)</i>	Three months ended September 30, 2018	Six months ended September 30, 2018
Obligated backlog, beginning of period (restated)	\$ 6,691.0	\$ 6,839.4
+ order intake	985.9	1,674.9
- revenue	(743.8)	(1,465.8)
+ / - adjustments	(27.6)	(143.0)
Obligated backlog, end of period	\$ 6,905.5	\$ 6,905.5
Joint venture backlog ³ (all obligated)	399.6	399.6
Unfunded backlog and options ³	1,362.5	1,362.5
Total backlog	\$ 8,667.6	\$ 8,667.6

The book-to-sales ratio for the quarter was 1.33x. The ratio for the last 12 months was 1.30x.

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

³ Non-GAAP and other financial measures (see Section 5).

7. RESULTS BY SEGMENT

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

- Civil Aviation Training Solutions;
- Defence and Security;
- Healthcare.

The method used for the allocation of assets jointly used by the 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 based on a proportion of each segment's cost of sales.

Unless otherwise indicated, elements within our segment revenue and segment operating income analysis are presented in order of magnitude.

KEY PERFORMANCE INDICATORS

Segment operating income

<i>(amounts in millions, except operating margins)</i>		Q2-2019	Q1-2019	Q4-2018	Q3-2018	Q2-2018
Civil Aviation Training Solutions	\$	63.3	78.3	74.5	119.4	67.3
	%	16.1	18.2	18.8	22.1	21.2
Defence and Security	\$	34.1	21.5	36.3	30.3	33.3
	%	10.6	8.0	12.5	11.7	12.2
Healthcare	\$	1.3	(1.3)	6.7	1.5	2.2
	%	4.3	—	19.1	5.4	7.8
Total segment operating income	\$	98.7	98.5	117.5	151.2	102.8

Capital employed⁴

<i>(amounts in millions)</i>		Q2-2019	Q1-2019	Q4-2018	Q3-2018	Q2-2018
Civil Aviation Training Solutions	\$	2,054.2	2,097.3	2,041.8	1,966.4	1,778.5
Defence and Security	\$	1,026.2	1,057.7	944.2	920.1	933.2
Healthcare	\$	209.4	208.8	211.5	205.0	206.4
	\$	3,289.8	3,363.8	3,197.5	3,091.5	2,918.1

⁴ Non-GAAP and other financial measures (see Section 5).

7.1 Civil Aviation Training Solutions

SECOND QUARTER OF FISCAL 2019 EXPANSIONS AND NEW INITIATIVES

Expansions

- We announced the expansion of our training capacity in Europe with the inauguration of a new Airbus A350 FFS in Madrid, Spain;
- We announced, together with Japan Airlines, the expansion of our training capacity with the inauguration of a new Airbus A320 FFS at the JAL CAE Flight Training centre joint venture in Tokyo, Japan.

New programs and products

- We announced, together with the Abu Dhabi Aviation Training Centre, the capability to conduct FAA-approved training, testing and certification for type-ratings on a new Embraer ERJ 145 FFS platform;
- We launched a cadet pilot training program in partnership with Vueling.

ORDERS

Civil Aviation Training Solutions obtained contracts this quarter expected to generate future revenues of \$575.3 million including contracts for 16 FFSs sold in the quarter, bringing the civil FFS order intake for the first six months of the fiscal year to 34 FFSs.

Notable contract awards for the quarter included:

- An exclusive 8-year pilot training contract with CityJet;
- An exclusive long-term pilot training contract with OceanAir;
- A new 5-year Multi-Crew Pilot License cadet training program with Air Asia;
- A new long-term training contract with Starspeed;
- An exclusive 2-year pilot training contract with LOT Polish Airlines;
- An exclusive pilot training contract with Air Busan through our joint venture, CAE Korea.

FINANCIAL RESULTS

(amounts in millions, except operating margins, SEU, FFSs deployed, utilization rate and FFS deliveries)

	Q2-2019	Q1-2019	Q4-2018	Q3-2018	Q2-2018
Revenue	\$ 393.1	430.9	395.3	540.5	317.9
Segment operating income	\$ 63.3	78.3	74.5	119.4	67.3
Operating margins	% 16.1	18.2	18.8	22.1	21.2
SOI before the impact of the net gains on strategic transactions related to our Asian joint ventures	\$ 63.3	78.3	74.5	115.4	53.0
Operating margins	% 16.1	18.2	18.8	21.4	16.7
Depreciation and amortization	\$ 37.1	34.9	33.7	35.9	31.8
Property, plant and equipment expenditures	\$ 36.0	47.2	50.2	38.9	21.9
Intangible assets and other assets expenditures	\$ 8.5	7.7	4.1	6.3	1.9
Capital employed	\$ 2,054.2	2,097.3	2,041.8	1,966.4	1,778.5
Total backlog	\$ 4,310.8	4,148.2	4,131.1	3,925.6	3,337.4
SEU ⁵	215	213	212	205	199
FFSs deployed in CAE's network	264	260	255	252	249
Utilization rate ⁵	% 72	80	82	75	70
FFS deliveries	5	12	8	18	11

Revenue up 24% compared to the second quarter of fiscal 2018

The increase in revenue from the second quarter of fiscal 2018 was mainly due to higher revenue recognized from simulator sales due to program mix and timing of production milestones on devices for which revenue was recognized over time. The increase was also due to the integration into our results of the revenues from Asian Aviation Centre of Excellence Sdn. (AACE) following the acquisition in the third quarter of fiscal 2018 of the remaining 50% equity interest, the contribution of newly deployed simulators in our network mainly in Europe and the Americas, and higher FFS utilization in the Americas.

Revenue year to date was \$824.0 million, \$134.5 million or 20% higher than the same period last year. The increase was primarily due to higher revenue recognized from simulator sales due to program mix from our manufacturing facility, the integration into our results of the revenues from AACE, as described above, the contribution of newly deployed simulators in our network mainly in Europe and the Americas, and higher FFS utilization in the Americas.

⁵ Non-GAAP and other financial measures (see Section 5).

Segment operating income down 6% over the second quarter of fiscal 2018

Segment operating income was \$63.3 million (16.1% of revenue) this quarter, compared to \$67.3 million (21.2% of revenue) in the second quarter of fiscal 2018. Excluding the gain from the disposal of ZFTC, segment operating income would have been \$53.0 million or 16.7% of revenue in the second quarter of fiscal 2018. On this basis, the current period's segment operating income was up 19% over the same quarter last year.

Segment operating income decreased by \$4.0 million, or 6%, over the second quarter of fiscal 2018. The decrease was mainly due the gain in the second quarter of fiscal 2018 from the disposal of our equity interest in the joint venture ZFTC, partially offset by a favourable program mix from our manufacturing facility and higher FFS utilization, mainly in the Americas.

Segment operating income for the first six months of the year was \$141.6 million (17.2% of revenue), \$5.4 million or 4% higher than the same period last year. The increase was primarily due to higher revenue recognized from simulator sales, as described above, higher FFS utilization, mainly in the Americas, and the contribution of newly deployed simulators in our network. This is partially offset by the gain realized last year from the disposal of our equity interest in the joint venture ZFTC.

Property, plant and equipment expenditures at \$36.0 million this quarter

Growth capital expenditures were \$22.2 million for the quarter and maintenance capital expenditures were \$13.8 million.

Capital employed decreased by \$43.1 million from last quarter

The decrease from last quarter was mainly attributable to lower plant and equipment and intangible assets, mainly as a result of movements in foreign exchange rates.

Total backlog up 4% compared to last quarter

<i>(amounts in millions)</i>	Three months ended September 30, 2018	Six months ended September 30, 2018
Obligated backlog, beginning of period (restated)	\$ 3,849.3	\$ 3,835.3
+ order intake	575.3	1,074.6
- revenue	(393.1)	(824.0)
+ / - adjustments	(59.0)	(113.4)
Obligated backlog, end of period	\$ 3,972.5	\$ 3,972.5
Joint venture backlog (all obligated)	338.3	338.3
Total backlog	\$ 4,310.8	\$ 4,310.8

Adjustments this quarter were mainly due to negative foreign exchange movements.

This quarter's book-to-sales ratio was 1.46x. The ratio for the last 12 months was 1.49x.

7.2 Defence and Security**SECOND QUARTER OF FISCAL 2019 EXPANSIONS AND NEW INITIATIVES****Expansions**

- On July 31, 2018, we acquired the shares of AOCE, a provider of aircrew training services, operational test and evaluation, and engineering support services to the U.S. Department of Defense and U.S. intelligence service.

New programs and products

- We launched the CAE 700MR Series flight training device (FTD), a next-generation FTD designed specifically for military helicopter flight and mission training;
- We signed an agreement to support the H-47 Chinook helicopter being offered for the German Air Force's Schwerer Transporthubschrauber heavy-lift helicopter competition.

ORDERS

Defence and Security was awarded \$380.2 million in orders this quarter, including notable contract awards from:

- Undisclosed U.S. government customers to provide training and services on higher-level security programs through CAE USA Mission Solutions Inc., which includes the newly acquired AOCE;
- The New Zealand Defence Force to provide the Royal New Zealand Air Force with a CAE 700MR Series NH90 FTD as well as long-term maintenance and support services;
- The U.S. Air Force (USAF) to continue providing KC-135 aircrew training services as well as perform a range of simulator upgrades and modifications on KC-135 training devices;
- The USAF to provide comprehensive C-130H aircrew training services;
- Lockheed Martin to support the design and manufacture of additional C-130J simulators for the USAF.

FINANCIAL RESULTS

<i>(amounts in millions, except operating margins)</i>	Q2-2019	Q1-2019	Q4-2018	Q3-2018	Q2-2018
Revenue	\$ 320.3	268.3	290.5	259.8	272.0
Segment operating income	\$ 34.1	21.5	36.3	30.3	33.3
<i>Operating margins</i>	% 10.6	8.0	12.5	11.7	12.2
Depreciation and amortization	\$ 11.5	10.8	10.8	10.3	14.0
Property, plant and equipment expenditures	\$ 4.2	5.4	6.8	3.4	2.3
Intangible assets and other assets expenditures	\$ 9.6	8.4	9.2	3.6	5.2
Capital employed	\$ 1,026.2	1,057.7	944.2	920.1	933.2
Total backlog	\$ 4,356.8	3,898.1	3,937.2	3,609.3	3,666.9

Revenue up 18% over the second quarter of fiscal 2018

The increase over the second quarter of fiscal 2018 was mainly due to the integration into our results of AOCE, acquired this quarter, higher revenue from North American, Australian and Middle Eastern programs and a favourable foreign exchange impact on the translation of foreign operations, partially offset by lower revenue from European programs resulting from a higher level of activity in the prior year.

Revenue year to date was \$588.6 million, \$55.9 million or 10% higher than the same period last year. The increase was mainly due to higher revenue from North American and Australian programs and the integration into our results of AOCE, partially offset by lower revenue from European programs resulting from a higher level of activity in the prior year.

Segment operating income up 2% over the second quarter of fiscal 2018

Segment operating income was \$34.1 million (10.6% of revenue) this quarter, compared to \$33.3 million (12.2% of revenue) in the second quarter of fiscal 2018.

The increase over the second quarter of fiscal 2018 was mainly due to higher margins on certain European programs, higher volume on Australian and Middle Eastern programs, lower selling, general and administrative expenses, the integration into our results of AOCE and higher profitability in our joint ventures. The increase was partially offset by lower margins on North American programs and reorganizational and integration costs incurred this quarter, subsequent to the acquisition of AOCE.

Segment operating income for the first six months of the year was \$55.6 million (9.4% of revenue), \$1.7 million or 3% lower than the same period last year. The decrease was mainly due to lower margins on North American programs and reorganizational and integration costs incurred this quarter, subsequent to the acquisition of AOCE, partially offset by lower selling, general and administrative expenses and higher volume on Middle Eastern and Australian programs.

Capital employed decreased by \$31.5 million from last quarter

The decrease over last quarter was mainly due a lower investment in non-cash working capital resulting primarily from an increase in accounts payable and accrued liabilities and a decrease in accounts receivable. The decrease was also due to higher deferred gains and other non-current liabilities and was partially offset by an increase in intangible assets, mainly as a result of the acquisition of AOCE.

Total backlog up 12% compared to last quarter

<i>(amounts in millions)</i>	Three months ended September 30, 2018	Six months ended September 30, 2018
Obligated backlog, beginning of period (restated)	\$ 2,841.7	\$ 3,004.1
+ order intake	380.2	547.1
- revenue	(320.3)	(588.6)
+ / - adjustments	31.4	(29.6)
Obligated backlog, end of period	\$ 2,933.0	\$ 2,933.0
Joint venture backlog (all obligated)	61.3	61.3
Unfunded backlog and options	1,362.5	1,362.5
Total backlog	\$ 4,356.8	\$ 4,356.8

Adjustments this quarter were mainly due the acquisition of AOCE, partially offset by negative foreign exchange movements.

This quarter's book-to-sales ratio was 1.19x. The ratio for the last 12 months was 1.03x.

This quarter, \$563.8 million was added to the unfunded backlog, mainly as a result of the acquisition of AOCE, and \$176.9 million was transferred to obligated backlog.

7.3 Healthcare

SECOND QUARTER OF FISCAL 2019 EXPANSIONS AND NEW INITIATIVES

New programs and products

- We launched a fully redesigned CAE CathLabVR interventional simulator for endovascular diagnostic and procedures that is modular and fully portable for physician and resident training. This simulator was developed for both customer sales with clinical learning content and for a number of cardiology companies for OEM training programs;
- We, together with ASA, launched the Anesthesia SimSTAT - Robotic Surgery module, the third in a series of interactive screen-based anesthesia simulation modules, which has been approved by the American Board of Anesthesiology for MOCA credits.

Expansions

- We expanded our distributor contract with WorldPoint to sell CAE Ares manikins to simulation centres in North America, which gives us access to WorldPoint's unique network of customers.

ORDERS

CAE Healthcare sales this quarter were driven by patient and ultrasound simulators sold directly in North America and internationally through distributors.

FINANCIAL RESULTS

<i>(amounts in millions, except operating margins)</i>	Q2-2019	Q1-2019	Q4-2018	Q3-2018	Q2-2018
Revenue	\$ 30.4	22.8	35.1	27.9	28.3
Segment operating income (loss)	\$ 1.3	(1.3)	6.7	1.5	2.2
<i>Operating margins</i>	% 4.3	—	19.1	5.4	7.8
Depreciation and amortization	\$ 3.4	3.1	3.2	3.2	3.1
Property, plant and equipment expenditures	\$ 0.7	0.5	0.4	0.7	0.2
Intangible assets and other assets expenditures	\$ 1.5	1.9	2.1	1.5	2.3
Capital employed	\$ 209.4	208.8	211.5	205.0	206.4

Revenue up 7% over the second quarter of fiscal 2018

The increase over the second quarter of fiscal 2018 was mainly due to higher revenue from ultrasound and patient simulators, partially offset by a decrease in revenue from centre management solutions and interventional simulators.

Revenue year to date was \$53.2 million, \$1.0 million or 2% higher than the same period last year. The increase was mainly due to higher revenue from ultrasound and patient simulators. The increase was partially offset by lower revenue from interventional simulators as a result of a significant military order received in the prior year.

Segment operating income lower compared to the second quarter of fiscal 2018

Segment operating income was \$1.3 million (4.3% of revenue) this quarter, compared to \$2.2 million (7.8% of revenue) in the second quarter of fiscal 2018.

The decrease over the second quarter of fiscal 2018 was mainly due to higher investment in selling, general and administrative expenses, as well as increased research and development expenses to support recent product launches, partially offset by higher revenue, as described above, and a favourable product mix.

Segment operating income for the first six months of the year was nil, \$0.6 million lower than the same period last year. The decrease was mainly due to higher investment in selling, general and administrative expenses, which were partially offset by higher revenue, as described above, and a favourable product mix.

Capital employed increased by \$0.6 million from last quarter

The increase from last quarter was due to higher non-cash working capital driven by higher accounts receivable, partially offset by a decrease in intangible assets, mainly as a result of movements in foreign exchange rates.

8. CONSOLIDATED CASH MOVEMENTS AND LIQUIDITY

We 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.

8.1 Consolidated cash movements

<i>(amounts in millions)</i>	Three months ended		Six months ended	
	September 30		September 30	
	2018	2017	2018	2017
Cash provided by operating activities*	\$ 123.0	\$ 102.4	\$ 240.2	\$ 184.3
Changes in non-cash working capital	54.1	(5.3)	(93.7)	(106.4)
Net cash used in operating activities	\$ 177.1	\$ 97.1	\$ 146.5	\$ 77.9
Maintenance capital expenditures ⁶	(17.2)	(13.8)	(40.6)	(28.7)
Other assets	—	(3.4)	(4.9)	(8.4)
Proceeds from the disposal of property, plant and equipment	—	10.8	2.3	15.9
Net payments to equity accounted investees	(3.6)	(4.0)	(9.7)	(4.0)
Dividends received from equity accounted investees	7.1	—	7.1	17.1
Dividends paid	(25.7)	(23.2)	(48.8)	(44.2)
Free cash flow ⁶	\$ 137.7	\$ 63.5	\$ 51.9	\$ 25.6
Growth capital expenditures ⁶	(23.7)	(10.6)	(53.4)	(44.8)
Capitalized development costs	(15.6)	(6.0)	(28.7)	(12.1)
Common shares repurchased	(37.2)	(19.9)	(43.7)	(22.6)
Other cash movements, net	2.1	0.5	6.7	9.5
Business combinations, net of cash and cash equivalents acquired	(33.5)	(24.7)	(33.5)	(24.7)
Net proceeds from disposal of interest in investment	—	114.0	—	114.0
Effect of foreign exchange rate changes on cash and cash equivalents	(8.7)	(5.8)	(14.8)	(4.4)
Net change in cash before proceeds and repayment of long-term debt	\$ 21.1	\$ 111.0	\$ (115.5)	\$ 40.5

* before changes in non-cash working capital

Free cash flow of \$137.7 million this quarter

The increase from the second quarter of fiscal 2018 was mainly due to a lower investment in non-cash working capital and an increase in cash provided by operating activities, partially offset by a decrease in proceeds from the disposal of property, plant and equipment.

Free cash flow year to date was \$51.9 million, \$26.3 million higher than the same period last year. The increase was mainly attributable to an increase in cash provided by operating activities, partially offset by a decrease in proceeds from the disposal of property, plant and equipment, higher maintenance capital expenditures and lower dividends received from equity accounted investees.

Capital expenditures of \$40.9 million this quarter

Growth capital expenditures were \$23.7 million this quarter and \$53.4 million for the first six months of the year. Maintenance capital expenditures were \$17.2 million this quarter and \$40.6 million for the first six months of the year.

Business combinations of \$33.5 million for the quarter

The cash movement resulting from business combinations was due to the acquisition of AOCE.

⁶ Non-GAAP and other financial measures (see Section 5).

9. CONSOLIDATED FINANCIAL POSITION

9.1 Consolidated capital employed

<i>(amounts in millions)</i>	As at September 30 2018	As at June 30 2018	As at March 31 2018
Use of capital:			
Current assets	\$ 2,149.5	\$ 2,108.0	\$ 2,123.3
Less: cash and cash equivalents	(504.3)	(500.1)	(611.5)
Current liabilities	(1,592.4)	(1,488.8)	(1,474.1)
Less: current portion of long-term debt	129.8	119.2	52.2
Non-cash working capital ⁷	\$ 182.6	\$ 238.3	\$ 89.9
Property, plant and equipment	1,782.8	1,818.9	1,803.9
Other long-term assets	1,897.4	1,864.0	1,853.0
Other long-term liabilities	(785.1)	(794.1)	(799.9)
Total capital employed	\$ 3,077.7	\$ 3,127.1	\$ 2,946.9
Source of capital⁷:			
Current portion of long-term debt	\$ 129.8	\$ 119.2	\$ 52.2
Long-term debt	1,169.6	1,192.4	1,208.7
Less: cash and cash equivalents	(504.3)	(500.1)	(611.5)
Net debt ⁷	\$ 795.1	\$ 811.5	\$ 649.4
Equity attributable to equity holders of the Company	2,207.9	2,242.6	2,229.1
Non-controlling interests	74.7	73.0	68.4
Source of capital	\$ 3,077.7	\$ 3,127.1	\$ 2,946.9

Capital employed decreased \$49.4 million from last quarter

The decrease was mainly due to lower non-cash working capital and lower property, plant and equipment, partially offset by higher other long-term assets.

Our ROCE⁷ was 14.5% this quarter, compared to 11.1% in the second quarter of last year and 14.6% last quarter. ROCE was impacted by the income tax recovery resulting from the enactment of a lower U.S. federal corporate income tax rate and the net gains on strategic transactions relating to our Asian joint ventures in fiscal 2018. Excluding these impacts, ROCE would have been 12.8% this quarter and 12.6% last quarter.

Non-cash working capital decreased by \$55.7 million from last quarter

The decrease was mainly due to higher accounts payable and accrued liabilities and higher contract liabilities, partially offset by higher inventories.

Property, plant and equipment decreased \$36.1 million from last quarter

The decrease was mainly due to movements in foreign exchange rates and depreciation, partially offset by capital expenditures.

Other long-term assets increased \$33.4 million from last quarter

The increase was mainly due to higher intangible assets, primarily resulting from the acquisition of AOCE.

⁷ Non-GAAP and other financial measures (see Section 5).

Change in net debt

<i>(amounts in millions, except net debt-to-capital)</i>	Three months ended September 30, 2018	Six months ended September 30, 2018
Net debt, beginning of period	\$ 811.5	\$ 649.4
Impact of cash movements on net debt (see table in the consolidated cash movements section)	(21.1)	115.5
Effect of foreign exchange rate changes on long-term debt	(13.7)	2.1
Impact from business combinations	14.9	14.9
Other	3.5	13.2
Change in net debt during the period	\$ (16.4)	\$ 145.7
Net debt, end of period	\$ 795.1	\$ 795.1
Net debt-to-capital ⁸	% 25.8	

We have a committed line of credit at floating rates, provided by a syndicate of lenders. We and some of our subsidiaries can borrow funds directly from this credit facility to cover operating and general corporate expenses and to issue letters of credit and bank guarantees.

We also have an agreement to sell certain of our accounts receivable (current financial assets program) for an amount up to USD \$300.0 million.

In April 2018, we entered into a term loan for the financing of several simulators for our operations in South East Asia. This represents a loan obligation of \$55.0 million as at September 30, 2018.

In April 2018, we repurchased various assets previously financed under capital leases. The purchase was financed by way of a term loan representing an obligation of \$16.4 million as at September 30, 2018.

In June 2018, we repaid \$28.9 million of non-recourse term loans, acquired as part of the acquisition of the remaining 50% equity interest in AACE.

We have certain debt agreements which require the maintenance of standard financial covenants. As at September 30, 2018, we are compliant with all our financial covenants.

We believe that our cash and cash equivalents, access to credit facilities and expected free cash flow will provide sufficient flexibility for our business, the repurchase of common shares and the payment of dividends and will enable us to meet all other expected financial requirements in the near term.

Total equity decreased by \$33.0 million this quarter

The decrease in equity was mainly due an unfavourable foreign currency translation of \$58.8 million, common shares repurchased and cancelled pursuant to our Normal Course Issuer Bid (NCIB) of \$37.2 million and dividends of \$25.7 million, partially offset by net income of \$63.6 million and favourable defined benefit plan remeasurements of \$21.2 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 266,574,989 common shares issued and outstanding as at September 30, 2018 with total share capital of \$639.3 million. In addition, we had 7,350,450 options outstanding under the Employee Stock Option Plan (ESOP).

As at October 31, 2018, we had a total of 266,306,889 common shares issued and outstanding and 7,288,175 options outstanding under the ESOP.

Repurchase and cancellation of shares

On February 9, 2018 we announced the renewal of the NCIB to purchase up to 5,349,804 of our common shares. The NCIB began on February 23, 2018 and will end on February 22, 2019 or on such earlier date when we complete our purchases or elect to terminate the NCIB. These purchases will be made on the open market plus brokerage fees through the facilities of the TSX and/or alternative trading systems at the prevailing market price at the time of the transaction, in accordance with the TSX's applicable policies. All common shares purchased pursuant to the NCIB will be cancelled.

During the three months ended September 30, 2018, we repurchased and cancelled a total of 1,419,600 common shares (2017 – 954,100) under the NCIB, at a weighted average price of \$26.17 per common share (2017 – \$20.84), for a total consideration of \$37.2 million (2017 – \$19.9 million). An excess of \$33.8 million (2017 – \$17.7 million) of the shares' repurchase value over their carrying amount was charged to retained earnings as share repurchase premiums.

⁸ Non-GAAP and other financial measures (see Section 5).

10. BUSINESS COMBINATIONS

Alpha-Omega Change Engineering

On July 31, 2018, we acquired the shares of Alpha-Omega Change Engineering Inc. (AOCE) for cash consideration (net of cash acquired) of \$33.5 million, subject to purchase price adjustments. AOCE is a provider of aircrew training services, operational test and evaluation, and engineering support services to the U.S. Department of Defense and U.S. intelligence service.

The purchase price is mainly allocated to goodwill and intangible assets. The acquisition will enhance our core capabilities as a training systems integrator, grow our position on enduring platforms such as fighter aircraft, and expand our ability to pursue higher-level security programs in the United States.

The net assets acquired, including intangibles, are included in the Defence and Security segment.

The purchase price allocation is expected to be completed as soon as management has gathered all the significant information available and considered necessary to finalize the allocation.

11. EVENT AFTER THE REPORTING PERIOD

On November 8, 2018, we announced that we have agreed to acquire Bombardier's Business Aircraft Training (BAT) business for a consideration of US \$645 million, before liabilities assumed. The acquisition will provide us with a specialized workforce, a portfolio of customers, and 12 business jet FFSs and training devices to add to our training network. The closing of the transaction is subject to regulatory approvals and is expected to occur by the second half of calendar year 2019.

In addition to the agreement to acquire Bombardier's BAT business, we have agreed to pay US \$155 million to Bombardier to monetize our future royalty obligations under the current ATP agreement. This also involves the extension of our ATP agreement with Bombardier to 2038. This transaction is expected to close by the end of CAE's current fiscal year.

The transactions will be financed through a combination of cash on hand, drawing on the existing bank facility and new committed term loans.

12. CHANGES IN ACCOUNTING POLICIES

New and amended standards adopted

IFRS 15 - Revenue from contracts with customers

In May 2014, the IASB released IFRS 15 - *Revenue from Contracts with Customers*, which supersedes IAS 11 - *Construction Contracts* and IAS 18 - *Revenue* and related interpretations. The core principle of the new standard is to recognize revenue to depict fulfillment of performance obligations to customers in amounts that reflect the consideration to which we expect to be entitled in exchange for those goods or services. Revenue is recognized when, or as, the customer obtains control of the goods or services. The new standard also provides guidance for transactions that were not previously addressed comprehensively, improves guidance for multiple-element arrangements and enhances revenue related disclosures.

IFRS 15 was adopted effective April 1, 2018 for CAE. We elected to implement the standard using the full retrospective method, which requires the restatement of our 2018 results, and an opening adjustment to equity as at April 1, 2017. We have also elected to use the following practical expedients:

- No restatement for contracts that were completed as at, or prior to April 1, 2017;
- Reflecting the aggregate effect of modifications to contracts that occurred prior to April 1, 2017 when identifying the satisfied and unsatisfied performance obligations and when determining the transaction prices to be allocated thereto; and
- For all periods presented prior to April 1, 2018, the amount of the transaction price allocated to the remaining performance obligations or expected depletion of that amount will not be disclosed.

We have reviewed our revenue contracts to evaluate the effect of the new standard on our revenue recognition practices. The adoption of the new standard had the following impacts:

- Revenue recognition for certain performance obligations previously accounted for using the percentage-of-completion method no longer meet the requirements for revenue recognition over time. Revenue for these performance obligations are recognized upon completion. As the performance obligations for these devices are met and manufacturing advances, the costs to build are recognized as inventory;
- Contracts in which we receive significant payment in advance now require a portion of the contract consideration to be allocated to a significant financing component, when certain criteria are met;
- Identification of performance obligations for certain multiple-element arrangements is changed;
- We previously presented contract assets and liabilities related to construction contracts in the contracts in progress accounts, while balances related to the sale of goods and services were presented in accrued receivables and deferred revenue. All contract balances, on a contract-by-contract basis, are now presented in contract assets or contract liabilities.

The cumulative effect of the impacts of adopting IFRS 15 are presented in the tables below:

Reconciliation of financial position

<i>(amounts in millions)</i>	April 1, 2017			March 31, 2018		
	As previously reported	IFRS 15 Adjustments	As restated	As previously reported	IFRS 15 Adjustments	As restated
Assets						
Cash and cash equivalents	\$ 504.7	\$ —	\$ 504.7	\$ 611.5	\$ —	\$ 611.5
Accounts receivable	548.4	(98.3)	450.1	568.4	(116.4)	452.0
Contracts in progress: assets	337.5	(337.5)	—	401.6	(401.6)	—
Contract assets	—	348.5	348.5	—	439.7	439.7
Inventories	416.3	132.7	549.0	375.3	140.8	516.1
Prepayments	63.8	—	63.8	50.0	—	50.0
Income taxes recoverable	25.6	—	25.6	40.7	—	40.7
Derivative financial assets	23.4	—	23.4	13.3	—	13.3
Total current assets	\$ 1,919.7	\$ 45.4	\$ 1,965.1	\$ 2,060.8	\$ 62.5	\$ 2,123.3
Property, plant and equipment	1,582.6	—	1,582.6	1,803.9	—	1,803.9
Intangible assets	944.0	—	944.0	1,055.6	—	1,055.6
Investment in equity accounted investees	378.4	(2.6)	375.8	244.5	(1.8)	242.7
Deferred tax assets	42.8	0.1	42.9	60.9	0.3	61.2
Derivative financial assets	16.0	—	16.0	11.5	—	11.5
Other assets	471.3	—	471.3	482.0	—	482.0
Total assets	\$ 5,354.8	\$ 42.9	\$ 5,397.7	\$ 5,719.2	\$ 61.0	\$ 5,780.2
Liabilities and equity						
Accounts payable and accrued liabilities	\$ 695.2	\$ (9.1)	\$ 686.1	\$ 669.6	\$ (2.7)	\$ 666.9
Provisions	43.2	—	43.2	32.1	—	32.1
Income taxes payable	9.6	—	9.6	15.3	—	15.3
Deferred revenue	266.6	(255.2)	11.4	371.5	(361.5)	10.0
Contracts in progress: liabilities	191.9	(191.9)	—	161.8	(161.8)	—
Contract liabilities	—	593.4	593.4	—	679.5	679.5
Current portion of long-term debt	51.9	—	51.9	52.2	—	52.2
Derivative financial liabilities	15.5	—	15.5	18.1	—	18.1
Total current liabilities	\$ 1,273.9	\$ 137.2	\$ 1,411.1	\$ 1,320.6	\$ 153.5	\$ 1,474.1
Provisions	39.1	—	39.1	39.5	—	39.5
Long-term debt	1,203.5	—	1,203.5	1,208.7	—	1,208.7
Royalty obligations	138.5	—	138.5	140.8	—	140.8
Employee benefits obligations	157.7	—	157.7	200.6	—	200.6
Deferred gains and other liabilities	217.8	—	217.8	229.9	—	229.9
Deferred tax liabilities	238.6	(25.6)	213.0	208.1	(23.4)	184.7
Derivative financial liabilities	4.7	—	4.7	4.4	—	4.4
Total liabilities	\$ 3,273.8	\$ 111.6	\$ 3,385.4	\$ 3,352.6	\$ 130.1	\$ 3,482.7
Equity						
Share capital	\$ 615.4	\$ —	\$ 615.4	\$ 633.2	\$ —	\$ 633.2
Contributed surplus	19.4	—	19.4	21.3	—	21.3
Accumulated other comprehensive income	193.7	(2.6)	191.1	262.3	(2.0)	260.3
Retained earnings	1,192.3	(66.1)	1,126.2	1,381.4	(67.1)	1,314.3
Equity attributable to equity holders of the Company	\$ 2,020.8	\$ (68.7)	\$ 1,952.1	\$ 2,298.2	\$ (69.1)	\$ 2,229.1
Non-controlling interests	60.2	—	60.2	68.4	—	68.4
Total equity	\$ 2,081.0	\$ (68.7)	\$ 2,012.3	\$ 2,366.6	\$ (69.1)	\$ 2,297.5
Total liabilities and equity	\$ 5,354.8	\$ 42.9	\$ 5,397.7	\$ 5,719.2	\$ 61.0	\$ 5,780.2

Reconciliation of net income

	Three months ended September 30, 2017			Six months ended September 30, 2017		
	As previously reported	IFRS 15 Adjustments	As restated	As previously reported	IFRS 15 Adjustments	As restated
Revenue	\$ 646.0	\$ (27.8)	\$ 618.2	\$ 1,344.9	\$ (70.5)	\$ 1,274.4
Cost of sales	458.0	(21.3)	436.7	944.2	(55.0)	889.2
Gross profit	\$ 188.0	\$ (6.5)	\$ 181.5	\$ 400.7	\$ (15.5)	\$ 385.2
Research and development expenses	30.0	—	30.0	62.3	—	62.3
Selling, general and administrative expenses	75.1	—	75.1	169.9	—	169.9
Other gains – net	(18.3)	—	(18.3)	(18.0)	—	(18.0)
After tax share in profit of equity accounted investees	(8.1)	—	(8.1)	(20.6)	(2.5)	(23.1)
Operating profit	\$ 109.3	\$ (6.5)	\$ 102.8	\$ 207.1	\$ (13.0)	\$ 194.1
Finance expense – net	17.5	0.1	17.6	35.3	0.5	35.8
Earnings before income taxes	\$ 91.8	\$ (6.6)	\$ 85.2	\$ 171.8	\$ (13.5)	\$ 158.3
Income tax expense	24.8	(1.7)	23.1	39.4	(4.4)	35.0
Net income	\$ 67.0	\$ (4.9)	\$ 62.1	\$ 132.4	\$ (9.1)	\$ 123.3
Attributable to:						
Equity holders of the Company	\$ 65.2	\$ (4.9)	\$ 60.3	\$ 129.0	\$ (9.1)	\$ 119.9
Non-controlling interests	1.8	—	1.8	3.4	—	3.4
Earnings per share attributable to equity holders of the Company						
Basic	\$ 0.24	\$ (0.02)	\$ 0.22	\$ 0.48	\$ (0.03)	\$ 0.45
Diluted	\$ 0.24	\$ (0.02)	\$ 0.22	\$ 0.48	\$ (0.04)	\$ 0.44

	Year ended March 31, 2018		
	As previously reported	IFRS 15 Adjustments	As restated
Revenue	\$ 2,830.0	\$ (6.5)	\$ 2,823.5
Cost of sales	1,953.1	(7.5)	1,945.6
Gross profit	\$ 876.9	\$ 1.0	\$ 877.9
Research and development expenses	114.9	—	114.9
Selling, general and administrative expenses	380.8	—	380.8
Other gains – net	(37.4)	—	(37.4)
After tax share in profit of equity accounted investees	(42.4)	(0.8)	(43.2)
Operating profit	\$ 461.0	\$ 1.8	\$ 462.8
Finance expense – net	76.2	1.0	77.2
Earnings before income taxes	\$ 384.8	\$ 0.8	\$ 385.6
Income tax expense	29.1	1.8	30.9
Net income	\$ 355.7	\$ (1.0)	\$ 354.7
Attributable to:			
Equity holders of the Company	\$ 347.0	\$ (1.0)	\$ 346.0
Non-controlling interests	8.7	—	8.7
Earnings per share attributable to equity holders of the Company			
Basic	\$ 1.29	\$ —	\$ 1.29
Diluted	\$ 1.29	\$ (0.01)	\$ 1.28

While the timing of contract revenue and profit recognition is impacted, there is no change to cash flows.

The key changes to our accounting policies are summarized below:

Revenue Recognition

Performance Obligations

A performance obligation is a contractual promise with a customer to transfer a distinct good or service and is the unit of account for revenue recognition.

A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. The transaction price includes, among other things and when applicable, an estimate of variable consideration only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognized will not subsequently occur. Variable consideration is usually derived from sales incentives, in the form of discounts or volume rebates, and penalties. We also account for a significant financing component on contracts where timing of cash receipts and revenue recognition differ substantially.

For contracts with multiple performance obligations, the contract's transaction price is allocated based on the estimated relative stand-alone selling prices of the promised goods or services underlying each performance obligation. If a stand-alone selling price is not directly observable from stand-alone sales of goods or services to similar customers, we estimate the stand-alone selling price using the expected cost plus a margin approach.

Our performance obligations are satisfied over time or at a point in time.

Revenues from contracts with customers for the design, engineering, and manufacturing of training devices is recognized over time using the cost input method, if we determine that these devices have no alternative use and we have enforceable rights to payment for work completed to date. When we determine that there is an alternative use for these devices, revenue is recognized when the customer obtains control upon completion.

Revenues from the sale of training hours or training courses are recognized at a point in time, at completion.

Revenues from the sale of product maintenance services and post-delivery customer support are recognized over time, using the time elapsed output method. Revenues from update services are recognized over time, using the cost input method.

Contract balances

Account receivables include amounts billed and currently due from customers. A contract asset is recognized when revenue is recognized in excess of billings or when we have a right to consideration and that right is conditional to something other than the passage of time. A contract liability is recognized for payments received in excess of revenue recognized. Contract assets and contract liabilities are reported in a net position on a contract-by-contract basis at the end of each reporting period.

Use of judgements, estimates and provisions

The application of IFRS 15 requires us to make judgements and estimates that affect the timing and amount of revenue from contracts with customers, including judgements and estimates regarding:

- The combination of contracts;
- The transaction price and the amounts allocated to performance obligations;
- The timing of satisfaction of performance obligations.

IFRS 9 - Financial instruments

In July 2014, the IASB released the final version of IFRS 9 - *Financial Instruments* replacing IAS 39 - *Financial Instruments: Recognition and Measurement*. IFRS 9 incorporates all three aspects of the accounting for financial instruments: classification and measurement, impairment and hedge accounting.

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics. The new standard largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities.

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. Specifically, the new standard requires entities to account for expected credit losses when financial instruments are first recognized and requires the recognition of expected credit losses on a timelier basis.

The new hedge accounting model is more principles-based and aligns hedge accounting more closely with risk management.

IFRS 9 was adopted retrospectively, with the initial application date as of April 1, 2018. The adoption of this standard had no impact on our consolidated financial statements.

The key changes to our accounting policies are summarized below:

Financial instruments

Classification and measurement

Financial assets are initially recognized at fair value and are subsequently classified either as measured at amortized cost, fair value through other comprehensive income (FVOCI) or fair value through profit or loss (FVTPL).

A financial asset for which the contractual terms give rise to cash flows that are solely payments of principal and interest is classified as being subsequently measured at amortized cost if the asset is held within a business model whose objective is to collect contractual cash flows and at FVOCI if it is held in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

All other financial assets are classified as being subsequently measured at FVTPL, except if at initial recognition of an equity investment that is not held for trading, we elect to present in OCI subsequent changes in its fair value. For equity investments for which subsequent changes in fair value are presented in OCI, the amounts recognized in OCI are never reclassified to income.

The existing IAS 39 categories of held-to-maturity, loans and receivable and available-for-sale are eliminated. Our financial assets classified as loans and receivables and available-for-sale at March 31, 2018 have been reclassified respectively to financial assets at amortized cost and FVOCI.

Impairment

The 'expected credit loss' model applies to financial assets carried at amortized cost. The model uses a dual measurement approach, under which the loss allowance is measured as either: the 12-month expected credit losses or at the lifetime expected credit losses. We have applied the simplified approach and record lifetime expected losses on accounts receivable and contract assets.

Hedge accounting

All existing hedge relationships that are currently designated as effective hedging relationships continue to qualify for hedge accounting under IFRS 9. IFRS 9 does not change the general principles of how we account for effective hedges but introduces a new hedge accounting model that requires us to ensure that the hedge accounting is more closely aligned with our risk management objectives and strategy. The new model also requires us to apply a more qualitative and forward-looking approach to assessing hedge effectiveness.

New and amended standards not yet adopted

IFRS 16 - Leases

In January 2016, the IASB released IFRS 16 - *Leases*, which will replace IAS 17 - *Leases* and related interpretations. The new standard introduces a single lessee accounting model and eliminates the classification of leases as either operating or finance leases. It requires the lessee to recognize a right-of-use asset and a lease obligation for substantially all leases. Lessors will continue to classify leases as operating leases or finance leases as IFRS 16 substantially carries forward the current lessor accounting requirements.

IFRS 16 will be effective for the fiscal period beginning on April 1, 2019 for CAE. We are currently evaluating the impact of the new standard on our consolidated financial statements. Where we are the lessee for leases that are considered operating leases under IAS 17, the adoption of IFRS 16 is expected to result in the recognition of assets and liabilities on the consolidated statement of financial position. The change to the recognition, measurement and presentation requirements from the adoption of this standard is expected to result in a decrease of our operating lease expense and an increase of our finance and depreciation expenses.

13. CONTROLS AND PROCEDURES

In the second quarter ended September 30, 2018, we did not make any significant changes in, nor take any significant corrective actions regarding our internal controls or other factors that could significantly affect such internal controls. Our CEO and CFO periodically review our disclosure controls and procedures for effectiveness and conduct an evaluation each quarter. As of the end of the second quarter, our CEO and CFO were satisfied with the effectiveness of our disclosure controls and procedures.

On July 31, 2018, we acquired AOCE. In accordance with National Instrument 52-109 - *Certification of Disclosure in Issuers' Annual and Interim Filings*, the CEO and the CFO of the Company have limited the scope of their design of CAE's disclosure controls and procedures and internal control over financial reporting to exclude controls, policies and procedures of AOCE. AOCE utilizes separate information systems and processes. We have begun to integrate AOCE's internal controls, policies and procedures. This integration process is expected to be completed during fiscal 2019. AOCE's contribution to our consolidated financial statements for the second quarter ended September 30, 2018, was approximately 4% of consolidated revenues and approximately 1% of total segment operating income. Additionally, at September 30, 2018, AOCE's total assets and total liabilities were 2% and 3% of consolidated total assets and liabilities, respectively.

14. SELECTED QUARTERLY FINANCIAL INFORMATION

<i>(amounts in millions, except per share amounts and exchange rates)</i>	Q1	Q2	Q3	Q4	Year to date
Fiscal 2019					
Revenue	\$ 722.0	743.8	(1)	(1)	1,465.8
Net income	\$ 71.6	63.6	(1)	(1)	135.2
Equity holders of the Company	\$ 69.4	60.7	(1)	(1)	130.1
Non-controlling interests	\$ 2.2	2.9	(1)	(1)	5.1
Basic EPS attributable to equity holders of the Company	\$ 0.26	0.23	(1)	(1)	0.49
Diluted EPS attributable to equity holders of the Company	\$ 0.26	0.23	(1)	(1)	0.48
Average number of shares outstanding (basic)	267.6	267.4	(1)	(1)	267.5
Average number of shares outstanding (diluted)	269.3	269.2	(1)	(1)	269.2
Average exchange rate, U.S. dollar to Canadian dollar	1.29	1.31	(1)	(1)	1.30
Average exchange rate, Euro to Canadian dollar	1.54	1.52	(1)	(1)	1.53
Average exchange rate, British pound to Canadian dollar	1.76	1.71	(1)	(1)	1.73
Fiscal 2018					
Revenue	\$ 656.2	618.2	828.2	720.9	2,823.5
Net income	\$ 61.2	62.1	145.8	85.6	354.7
Equity holders of the Company	\$ 59.6	60.3	143.8	82.3	346.0
Non-controlling interests	\$ 1.6	1.8	2.0	3.3	8.7
Basic EPS attributable to equity holders of the Company	\$ 0.22	0.22	0.54	0.31	1.29
Diluted EPS attributable to equity holders of the Company	\$ 0.22	0.22	0.53	0.31	1.28
EPS before the impacts of U.S. tax reform and net gains on strategic transactions related to our Asian joint ventures	\$ 0.22	0.20	0.38	0.31	1.11
Average number of shares outstanding (basic)	268.6	268.7	268.1	267.6	268.2
Average number of shares outstanding (diluted)	269.8	269.9	269.5	269.0	269.5
Average exchange rate, U.S. dollar to Canadian dollar	1.35	1.26	1.27	1.26	1.28
Average exchange rate, Euro to Canadian dollar	1.48	1.47	1.49	1.55	1.50
Average exchange rate, British pound to Canadian dollar	1.72	1.64	1.68	1.75	1.70
Fiscal 2017⁽²⁾					
Revenue	\$ 651.6	635.5	682.7	734.7	2,704.5
Net income	\$ 69.3	48.9	69.3	69.1	256.6
Equity holders of the Company					
Continuing operations	\$ 68.7	48.3	67.6	67.4	252.0
Discontinued operations	\$ (0.1)	0.1	0.2	(0.7)	(0.5)
Non-controlling interests	\$ 0.7	0.5	1.5	2.4	5.1
Basic EPS attributable to equity holders of the Company	\$ 0.25	0.18	0.25	0.25	0.94
Continuing operations	\$ 0.25	0.18	0.25	0.25	0.94
Discontinued operations	\$ —	—	—	—	—
Diluted EPS attributable to equity holders of the Company	\$ 0.25	0.18	0.25	0.25	0.93
Continuing operations	\$ 0.25	0.18	0.25	0.25	0.93
Discontinued operations	\$ —	—	—	—	—
Earnings per share before specific items ⁹	\$ 0.26	0.21	0.26	0.31	1.03
Average number of shares outstanding (basic)	269.3	268.7	268.5	268.3	268.7
Average number of shares outstanding (diluted)	269.6	269.6	269.7	269.6	269.6
Average exchange rate, U.S. dollar to Canadian dollar	1.29	1.30	1.33	1.32	1.31
Average exchange rate, Euro to Canadian dollar	1.46	1.46	1.44	1.41	1.44
Average exchange rate, British pound to Canadian dollar	1.85	1.71	1.66	1.64	1.71

(1) Not available.

(2) Figures have not been restated to reflect the adoption of IFRS 15. Refer to *Changes in accounting policies* for further details.⁹ Non-GAAP and other financial measures (see Section 5).