



REMARKS FOR CAE'S SECOND-QUARTER FISCAL YEAR 2010

November 11, 2009

Time: 1:00 p.m.

Speakers:

Mr. Marc Parent, President and Chief Executive Officer

Mr. Alain Raquepas, Vice President, Finance, and Chief Financial Officer

Mr. Andrew Arnovitz, Vice President, Investor Relations and Strategy



Andrew Arnovitz, Vice President, Investor Relations and Strategy

Good afternoon, everyone, and thank you for joining us today. Before we begin I need to read the following:

“Certain statements made during this conference, including, but not limited to, statements that are not historical facts, are forward-looking and are subject to important risks, uncertainties and assumptions. The results or events predicted in these forward-looking statements may differ materially from actual results or events. These statements do not reflect the potential impact of any non-recurring or other special items or events that are announced or completed after the date of this conference, including mergers, acquisitions, or other business combinations and divestitures.

You will find more information about the risks and uncertainties associated with our business in the MD&A section of our annual report and annual information form for the year ended March 31, 2009. These documents have been filed with the Canadian securities commissions and are available on our website (www.cae.com) and on SEDAR (www.sedar.com). They have also been filed with the U.S. Securities and Exchange Commission under Form 40-F and are available on EDGAR (www.sec.gov). Forward-looking statements in this conference represent our expectations as of today, November 11, 2009, and, accordingly, are subject to change after this date.

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

On the call with me this afternoon are Marc Parent, CAE’s President and Chief Executive Officer, and Alain Raquepas, our Chief Financial Officer.

After comments from Marc and Alain, we will take questions from financial analysts and institutional investors. Following the conclusion of that Q&A period we will open the call to members of the media.

For your convenience, this conference call will be archived on CAE’s website:

Let me now turn the call over to Marc...



Marc Parent, President and Chief Executive Officer

Thank you, Andrew, and good afternoon to everyone joining us on the call.

As CAE's new CEO, I have hit the ground running in a very challenging and exciting time. I very much appreciate the opportunity to discuss our second quarter results with you today.

By now you have seen our financials so we'll focus on some of the key highlights of the quarter and then I will provide you with our outlook. After that we'll welcome any questions and comments you might have.

(Pause)

Overall, we had a good performance in the second quarter, thanks to our strong military segments and because we moved quickly to adapt our civil business to current conditions.

We generated \$365 million of revenue on a consolidated basis and \$62 million of operating income for a margin of 17 percent.

We reduced non-cash working capital and generated \$94 million of free cash flow, which gave us the ability to further strengthen our balance sheet. Net debt at the end of the quarter was down by \$83 million to \$258 million. And net debt-to-capital is now 27 percent, which includes our off-balance sheet obligations.

We've been able to continue generating cash and profits, even though we've had a substantial drop in our civil business. We're still on track to complete our restructuring by the end of the fiscal year. So far, we've made good progress in lowering our cost base and scaling our operations to fit the current and expected market conditions.

The value of CAE's diversification can't be overstated. We benefit from global reach in all of our business segments. In civil, our activities in the Middle East, Asia and South America continued to help offset the declines in North America and Europe. The orders announced this week are concrete examples of our geographic reach.



We're well balanced between sectors: our two military segments accounted for 54 percent of revenue in the quarter and produced a combined operating margin of over 17 percent.

In **Training and Services/Civil** we booked orders with an expected value of \$83 million. The average annualized number of RSEUs in our network was 128, which is 10 more than last year but two less than we had in Q1. Since the start of the year we removed and sold three older simulators from our network.

Utilization was about 60% in the second quarter, compared with 66% last quarter and 71% last year. We're certainly not pleased with the low utilization but this reflects the brunt of the storm that we are going through. We view the six percentage point drop from Q1 to Q2 to be largely the result of normal seasonality as pilots fly during the busy summer months rather than train, as well as some additional market weakness. Last year's drop for the equivalent period was eight percentage points, and the year before that, utilization dropped five points. We've moved quickly to lower our fixed costs in this segment, which is the main reason why we've been able to perform, even at these low levels. We finished the quarter with an operating margin of 15.5 percent.

In **Simulation Products/Civil** we signed two full-flight simulator orders in the second quarter with Kenya Airways and Korean Air. Clearly, there are fewer opportunities this year compared to last year despite aircraft delivery rates, which so far haven't changed much. Sales are taking longer to conclude and because there are fewer of them, price competition is far more intense. On the positive side, as you saw earlier this week, we signed another two orders with Malaysia Airlines and Mount Cook Airlines of New Zealand, which brings our year-to-date total to 10 sales. We continue to target 20 sales for the year as a whole, and in the current environment, we think reaching that goal would be a success.

Revenue in Simulation Products/Civil was \$64 million. The lower volume is largely explained by lower orders, the extended shutdown of three weeks that we implemented in July and the furlough days that occurred during the quarter. We finished Q2 with a very strong operating margin of 19.4 percent, which doesn't yet fully reflect the extent of the downturn conditions and pricing pressure. Also, during the quarter we benefited from favourable currency hedges on contracts. Hedging has given us some time to adjust, but at a certain point, the prevailing exchange rates catch up. We have been cutting costs to mitigate as much of the Canadian dollar pressure as possible, but inevitably some will remain.



In the **combined military segments**, we won new orders totalling \$178 million in the second quarter, including major upgrades for German CH-53 helicopter simulators and a range of A330 Multi-Role Tanker Transport trainers for the UAE and the Royal Saudi Air Force. Our military business continued to deliver results that support our long-term positive outlook.

I'll now ask Alain to add a few brief comments on our financials.



Alain Raquepas, Chief Financial Officer

Thank you, Marc, and good afternoon everyone.

In the first quarter we saw an increase in non-cash working capital, which is usual for the start of the year. During the second quarter we reversed \$44 million of our investment in working capital accounts and looking at the balance of the year, we believe some further improvement is possible.

Capital expenditures totalled \$26 million and were roughly split between maintenance and growth expenditures. We continue to expect total CAPEX this year of \$150 million mainly in support of our prior commitments. About one third of this amount is for military. We are currently involved in our yearly strategic review and we will provide our outlook for FY11 expenditures with our Q4 results. That said, by the end of this year we will have substantially completed the build-up of our critical mass in business aviation training, so we expect to have additional flexibility to invest in other parts of our business.

During the quarter we incurred a restructuring charge of \$1.1 million, which is in addition to the \$27.2 million we incurred in the first quarter. We maintain our estimate for total restructuring costs of about \$32 million, the remainder to be incurred by year-end.

Finally, the effective tax rate this quarter was 27% because the proportion of income we generated in high tax rate jurisdictions like the U.S reduced and the proportion of income generated in lower rate jurisdictions like the Middle East increased. Accordingly, we have lowered our expected tax rate for the year to 29%.

Thank you for your attention.

Marc, back to you.



Marc Parent, Executive Vice President and Chief Operating Officer

Thanks, Alain.

In **Civil** we see some signs that the aviation sector is bottoming. Most airline statistics globally indicate that year-over-year traffic declines are easing. As well, the business jet market is starting to show some stability. Business jet utilization is still much lower than last year's levels, but year-over-year comparisons have also been more favourable over the last several months. Corporate profits however are ultimately what drives the business jet market; it will take renewed growth in corporate revenue - not just from cost cutting - to jumpstart that market.

In commercial aviation, we think recovery will be gradual over the next couple of years. It's still too early to give much precision on the pace of recovery but we have aligned ourselves to benefit from it when it comes.

Anyone who has followed CAE for a long time will know that our Simulation Products/Civil segment is a late cycle business and that its main driver is expected aircraft deliveries. By contrast, our training business is an early stage business. Changes in airline capacity and business aircraft utilization are reflected very quickly in this segment. When the downturn began, our civil training segment was the first to be affected, and when recovery takes hold, it should be the first to climb out. The main driver for civil training is the utilization of the already-installed aircraft fleet of commercial and business jet aircraft. New aircraft deliveries are a factor, but not the main driver for this segment.

Based on our backlog and our current read of the market, we expect our combined civil segments to generate an average annual operating margin in the mid-teens. We had a higher combined margin in the first half of the year, but in the coming quarters, we expect it to be lower in our civil products segment, as pricing pressure and foreign exchange impacts cycle through our backlog. The margin in our civil training and services segment should help to offset some of this pressure, as cost savings ramp up and the training segment gradually begins to pull out of the trough.

CAE is in a very different position than it was during the last aerospace market downturn. Back then, most of our business was tied to our most cyclical segment, which is Simulation Products/Civil. Today, this segment represents about only 20% of CAE's revenue – 18 percent



this quarter. We owe our resilience in the face of this downturn to our diversification and growth in the defence markets.

The outlook for our **combined military segments** is clearly positive. We achieved strong performance in the first half of the year and we continue to anticipate more than 10 percent combined revenue growth and 15 percent operating margins. And we expect new order activity this year to support our growth and profit outlook.

There are a number of trends that support our view that our military niche will continue to grow in the current environment. Historically, the adoption of simulation-based training has been much lower in the military than in civil aviation and we see governments increasingly intent on using simulation to reduce training costs and to provide better mission rehearsal capabilities. Governments also continue to move toward outsourcing services such as training and maintenance, and we've seen this materialize already in countries including Canada, the U.K., Germany and Australia.

Another important factor that underlies our assumption for continued growth in defence is the kinds of aircraft platforms that are most prevalent to CAE. Our "bread and butter" involves helicopters, transport aircraft, tanker aircraft and maritime patrol aircraft. These aircraft types are integral to maintaining national security in today's environment of persistent, low-intensity warfare. There will inevitably be some changes in governments' priorities but by and large, we see good opportunities ahead of us.

We continue to make small investments in our new initiatives, particularly in healthcare. While these initiatives will not contribute positively to earnings in the short term, we believe we can create long-term value by leveraging our capabilities in these new areas.

In conclusion, I think CAE has a great future. I've been with the company for almost five years, and I have had the chance to meet many of our customers and most of our employees around the world. It never ceases to impress me just how strong CAE's brand and reputation are. Our employees are proud of the quality of our products and services and are dedicated to offering the best to our customers.

We're facing considerable challenges in our civil markets and we're tackling them head-on. We've battened down the hatches by sizing our business and will continue to adjust to current and expected conditions. We've reduced costs so that we can navigate through the civil market



downturn and still generate decent cash flow and profits overall. The fundamentals of our business remain strong, and we're in a healthy financial position with a solid balance sheet. We have the flexibility to make investments in areas vital to our future. Military is achieving superior performance and we'll invest to support our continued success in that area. We have an excellent position in civil with our unique solutions-based, market approach. I am confident that when the civil market recovers, we will benefit from an even stronger CAE.

Thank you for your attention. We are now ready to take your questions.

Andrew?



Andrew Arnovitz, Vice President, Investor Relations and Strategy

Operator, we would now be pleased to take questions from analysts and institutional investors.

Before we open the lines, let me first ask in the interest of fairness that you please limit yourself to a single, one-part question. If you have additional questions and time permits, please feel free to re-enter the queue.