CORPORATE PARTICIPANTS

Marc Parent
President and Chief Executive Officer

Andrew Arnovitz
Senior Vice President, Investor Relations

Constantino Malatesta
Interim Chief Financial Officer

Nick Leontidis
Chief Operating Officer

CONFERENCE CALL PARTICIPANTS

Kevin Cheng
CIBC

Fadi Chamoun
BMO Capital Markets Equity Research

Konark Gupta
Scotiabank

Cameron Doerksen
National Bank Financial

Greg Konrad
Jeffries

Tim James
TD Collins

QUESTION AND ANSWER

Operator

Thank you. We will now begin the question and answer session. To join the question queue, you may press * then one on your telephone keypad. You'll hear a tone acknowledging your request. If you're using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press * then two. Our first question is from Kevin Cheng with CIBC. Please go ahead.

Kevin Cheng, CIBC

Hi, good morning here. Thanks for taking my question. Maybe just my first one, if I can dig into what's underpinning your civil outlook. I understand the prudency just given all the, all the macro uncertainty, but maybe we can dig into, you know, what you're seeing in terms of commercial training demand versus business jet training demand. And then on the margin outlook for the year, I guess I would have thought mix would have been more of a tailwind. You know, if you're selling fewer FFS this year and you have the full benefit of Simcon, maybe you can just walk me through some of the puts and takes on the margin outlook as well. Thank you.

Marc Parent, President and Chief Executive Officer

OK. Well, look, I'll kick it off and maybe turn over to Nick for some additional color on this of it. Look, I'm just going back to the civil outlook. I mean what we're doing, we're taking a measured approach, you know, specifically in light of the more cautious tone that we hear from airlines and you know a bit of a softness that we saw late in the fiscal year. You know, as we point out, the second-half is typically stronger and we've seen that I think every year I've been at CAE. So we're expecting a more moderated environment in, in the first half, both in terms of the what we see in terms of deliveries of simulators that we're going to execute and some near term uncertainty. But all that's reflected in the guidance that that we had. I think we'll hasten one thing is on the trade side and you know, cheer over to Nick, trade demand remains very resilient. I mean we see some regional variation. We see the pilot activity pick up recently in the United States. So we're watching that very closely. Coming back to similar deliveries, which will really function of the delivery of aircraft of out of Boeing and Airbus. I mean, what we see is the supply chain issues are getting better, but they continue to constrain the aircraft production itself. We're certainly not at peak production rates. So we're expecting modestly lower deliveries this in the first half of this year. So that's going to be a way for the back half. So those are some of the components. So maybe just add a little bit to that.

Nick Leontidis, Chief Operating Officer

I'm just going to say, yeah, Kevin, it's just the, you know, pilot hiring. If you go through the drivers, you know, pilot hiring, which is one of one driver is, is improving for sure, but not where they were last year. Aircraft deliveries, same thing. I mean things are improving actually with Boeing, but we've been pretty lopsided with Airbus being the vast majority of the deliveries. And therefore a lot of our product sales have been in Airbus versus Boeing. And so you, you know, and of course the customers themselves. There is a certain amount of I guess slack in the system right now because they were hiring at a certain level. So we just need to let all this kind of balance out a little bit, I think. And so we take, you know, when we look at the, when we look at the year, we look at the forecast and the guidance that we've given, I mean it's taking a little bit of that into consideration because obviously we see it improving. As Mark said, demand in the training centers is still quite strong. I mean, obviously it can always be stronger, but you know, the difference is not that not that big as you see. And, and you know, we are, you know, I mean, you know, mid to high single digit growth on a base of civil, which is this high is, you know, is something that it's not, you know, we need some of these, these drivers to improve.

Kevin Cheng, CIBC

That's helpful, you know. I'll leave it there. This is super helpful. Thank you very much.

Operator

The next question is from Fadi Chamoun with BMO. Please go ahead.

Fadi Chamoun, BMO Capital Markets Equity Research

OK. Good morning. Thank you for taking my question. I want to ask about the flight operation business. The, you know, you put together a few small acquisitions and Sabre and I think I recall you have been investing in kind of modernizing the software and modernizing the approach to market and that business. We recently saw Boeing sell the competing access to our private equity. I wanted to get your thoughts like what state of readiness that business segment is at right now from a competitive position perspective? And if you can give us some color about how it's performing relative to the level that you had expected by this time?

Marc Parent, President and Chief Executive Officer

OK. Yeah, Fadi, thanks for the question and I'll kick it off again with Nick. Look, I mean we're waiting in a market that's the first thing I'll say. You know we're very, and this is no discontinuing what I've said in previous call. We're winning a proportion of the business that we get in campaigns that we see out there. So our order book is growing, I can tell you. But basically I would say we're at capacity for the work that we can take on right now. And if anything, we're paced right now in terms of the growth at the speed at which the airlines can actually, you know, undergo the changes in their operation control centers. Because you know, when you're making a change, you're adopting a system like ours. You know, it takes, it takes a lot of time and effort to think to implement things like for a company implementing an ERP program, it's the same kind of thing. So there's a, it takes a lot. So you know you're working hand in hand with airlines and so we're kind of paced from that standpoint. But look again, we're avoiding in the market. We're very careful that we have a growth business for next few years. What we're seeing, what you're seeing us do right now is we're winning orders that are basically SAS kind of profile orders, which means that we are going to be recognizing the revenue and the earnings over a number of years as we execute those orders. It's kind of like the analogy we're moving, but rather selling a simulator. So selling like an on premise solution. We're delivery training, which is over quite a few years. So in terms of the execution of our business, that's where we stand, quite happy with our positioning market and we're executing well. We have, we have a strong order board. In terms of the question you asked about Boeing selling in the Jefferson deal. I think the strong level of interest that we saw in the market demonstrate the attractiveness of this side of the market. So I mean, I think basically that's what I'd point to that. Nick, you want anything more with that?

Nick Leontidis, Chief Operating Officer

No, I was just going to say right now that the business you know the number of implementations have ramped up significantly with all of the wins. So the way I would, the way I would look at this is we have about $700 million of orders and the average contract's about five years. So we have you know, a hundred 150 million of revenue sitting there that we need to implement, you know, solutions that we've sold and start to generate revenue. So you know the best is yet to come I guess is the way I would put it.

Fadi Chamoun, BMO Capital Markets Equity Research

OK. And just kind of follow up on these comments like from a scale perspective. Do you think you have the scale ultimately to be effective in this part of the business? And are you finding, I mean from the backlog, I guess the answer is yes. But are you finding a lot of energy in your commercial approach between kind of what you're doing on the training side and what you're doing on that flight operation side?

Marc Parent, President and Chief Executive Officer

You know, I'll just point to one thing. Just a recent example, we just had a big customer meeting of the business just last week in in Greece and we hosted that

that the our new AEGEAN training center and that was with the Co CEOs of AEGEAN. And I can tell you that the reaction of airlines to, they're basically witnessing the scope of CAE both in its training market and then then now in this in the service market just from a brand capability. I think there was definitely synergies there, but that's just anecdotal. Nick anything you want to add?

Nick Leontidis, Chief Operating Officer

No, I see you mean the synergies for this business are primarily in the front end. We have teams that are, that are active on both sides of the house when it comes to capturing customers and we leverage everything that we do with our customers to support, you know, more business with Flightscape in particular. So I mean, it's, you know, it's a different business, but it's another, it's another way for us to become, you know, at the end we want to become as important as we can to our customers and this is another way to do that.

Marc Parent, President and Chief Executive Officer

And maybe just add on, I don't think that would maybe that was part of your question Fadi, I mean be to be specific, I mean we have what we need in this business. Sounds like we need to add any more capability or through M&A or anything like that. This business, again the portfolio that we have and the various software platforms that we have allows us to have the success we have in the market, which is which is going to fuel a strong business for us as demonstrated in the 700 million of added backlog that Nick talked about.

Fadi Chamoun, BMO Capital Markets Equity Research

Thank you.

Operator

The next question is from Konark Gupta with Scotiabank. Please go ahead.

Konark Gupta, Scotiabank

Thanks and good morning. I just wanted to kind of touch on defense margin a bit here. You know, looking at obviously the last year the sequential progression has been pretty remarkable, but the margin exiting the fiscal year at about, call it 9%, you know, if we exclude the tax credit and the legacy dilution, what's keeping sort of the lid on your expectation for this fiscal year when you're expecting eight to eight and a half percent margin, I mean is there a timing in terms of how the legacy programs unfold or is there, you know, something in the mix in the backlog that's not letting the margin kind of exceed that 9% you saw in the latest quarter?

Marc Parent, President and Chief Executive Officer

Well, sorry, may I say we're not putting a lid on anything. We're, if you think about, you know, going to either and half percent on average, what's inherent in that is you could, could continue to see the inherently the progression, that kind of progression you saw this year, I think look well, well, I like to walk before we can run and we've been walking pretty fast and I think we're going to continue to do that. So look, I think, you saw it in the numbers we were confident in this year. We continue to feel very good about where we are, how we close the fiscal year. We're carrying very strong momentum into the new year. Look, and there's two, there's really two drivers behind the outlook that we're giving. First, what you're seeing is the benefit of strong program execution. You know, we're hitting the milestone. We're unlocking the cash, which by the way was a key contributor to the very strong free cash flow performance that we had this in the fourth quarter. And second, really we're ramping up higher margin programs that we want to commit to back up. If you remember the story that we've had, you know, for quite a few quarters now is that basically what we've been doing is basically retiring programs, executing a program that are inherently have been one at margins that are basically if you like dilutive or not accretive to the low double digit margin expectations we have of the business, replacing them with contracts that do. And that's continues to be the story here. And when you look at the size of the backlog, you know, ending the year at 11.3 backlog, which by the way, I would say and that's not over. We have like over $7 billion in bids and proposals that are outstanding, those are submitted to customers waiting, you know, in terms of a customer decision, I mean, I really position this extremely well, continue reshaping the business towards a high towards, you know, our goal of a higher quality, higher margin of work. So look, we, you know, we'll, so I, I continue again going back to say there's no lid on this business. I don't certainly expect a perfectly linear upward trajectory. We've done very well. Well, there's always going to be quarterly variability in this business because inherently when you execute depending on which programs you execute in, in any given quarter. But look, we, we just paid. Look for me, I would say cadence similar to last year performance building progressive progressively from Q1 onward. So look, I mean bottom line is, the fundamentals have very clearly improved. We've done and turned around this business and we're very good about this trajectory.

Konark Gupta, Scotiabank

Thanks, Mark. Mark, thank you. And I think you touched on the working capital aspect there. So I wanted to ask maybe from Dino, how should we think about the working capital in this fiscal year. Do you see these cash conversions continuing at a similar clip or the mix will have some implications?

Constantino Malatesta, Interim Chief Financial Officer

So thank you for the question. Effectively, I'm really, really pleased with their free cash flow generation of $290 million this quarter and the record 814 million free cash flow generated for 25, that's a conversion rate of 211%. So the capital allocation priorities do remain unchanged. You know the leveraging is essential part of what we're envisioning going forward. We are aiming to take our leverage down to 2.5 times by the end of the year. And that is again as a result of our confidence in the cash recurring jet cash generation nature of our business moving forward, as well as a maintaining a focus on capital discipline including non cash working capital. Now in this year we unlocked a lot from the non cash working capital for a 426 to help with the cash flow generation and the deleveraging goals. Next year we'll see a continued focus on non cash working capital efficiency and allowing us to maintain our 2.5 times deleveraging target for next year.

Konark Gupta, Scotiabank

Yeah. Thank you.

Operator

The next question is from Cameron Doerksen with National Bank Financial. Please go ahead.

Cameron Doerksen, National Bank Financial

Yeah, thanks. Good morning. Just maybe to follow up on the on the cash question, just on the CapEx indicating modest decline year over year. Maybe just two quick questions on this. I mean, one, what, what is your expectation for maintenance CapEx for 2026? Do we should we expect something similar to what we saw in 2025? And then secondly, maybe you can just sort of detail where I guess the growth CapEx is going for this year, what specific areas are you investing in?

Constantino Malatesta, Interim Chief Financial Officer

Thank you for the question, Cameron. So effectively we had adjusted our CapEx guidance to be 30 million higher than 2024 and we and we achieved that by hitting $356 million this year. So total CapEx expected to be modestly lower than last year. Again, continued example discipline capital approach. We invest organically to keep pace with the growth of our existing customers. Around 75% of next year's CapEx will be effectively to address some of the market deeds going forward, 25% maintenance traffic, so very similar to what we had this year. You know, generally speaking these opportunities give us the highest returns ramping up with the first years of deployment and reaching an average 20 to 30% pre tax incremental return of capital employed, right. We have experienced a more intensive multilayer deployment schedule recently. Now we're focused on cash generating returning capital and return on capital as well as long term margin profile. So a lot of discipline in in our execution going for next year working lock step with the market to make sure that we have the ability to address and reduce or any CapEx if the market calls for that.

Marc Parent, President and Chief Executive Officer

Just closing it off to Dino's comments. Cameron, look, you know we just come off as you know the you know set a multi year investment cycle. You know we invest a lot in new training work locations, yet we played offense during the downturn in a big way. We seized the opportunity, but we took share. We helped customers outsource their training. We built these centers for new programs, expanded a lot, particularly in business aircraft. So now we find ourselves in a place, a very attractive place where we're now consolidating and operationalizing that opportunity. And that really translations into the guys we have that basically both CapEx volumes and CapEx intensity is going off its peak.

Cameron Doerksen, National Bank Financial

OK, that that's helpful. And maybe just to follow up, I mean just thinking about the growth CapEx, I mean you know, largely driven by customer needs. I mean, should we think about the investment here is, is largely just adding simulators to existing training centers or are there still some areas where you think you need a new training center either on, on the civil side or on the business jet side?

Marc Parent, President and Chief Executive Officer

Yeah, no. So right. This year, the most of the CapEx that we're that we're spending is we're opening Vienna and we're expanding in Orlando after the acquisition. There's a, there's a few sims there. So and we have a couple of sims in one of our existing training centers in cap. So there's no, there's no planned new, you know, facilities, it's really just growing some of the some of the training operations that we were, you know it's part of the business case like some comments is a good example, the business case called for a bunch of simulators. So these simulators are starting to be manufactured now.

Cameron Doerksen, National Bank Financial

Ok. So that's very helpful. Thanks very much.

Operator

The next question is from Greg Connard with Jefferies. Please go ahead.

Greg Konrad, Jefferies

Good morning. Maybe just to focus on civil backlog, I mean you gave a little bit of color around flight operations, but if we think about 2025 growth in backlog of 37%, maybe mid single digit revenue growth, it implies a much higher coverage of 2026 revenue than you've historically have. What shifted in backlog either you know, from a margin perspective or just, you know, recognition just given the high coverage in 2026?

Marc Parent, President and Chief Executive Officer

I was a bit confused by where you always go. You started with basically your question with I think flight service or flight in that regard maybe add a little bit more segment overall and civil as a whole you're talking about?

Greg Konrad, Jefferies

Yeah. Just given the strong backlog growth and revenue outlook for 2026, I mean how you think about that backlog converting to revenue just given there seems to be a much higher coverage for 2026 than you've historically had just given the size of the backlog?

Andrew Arnovitz, Senior Vice President, Investor Relations

Yeah, Greg, it's Andrew. I think I know where you're coming from. You know one of the big components of the increase is the consolidation of the Simcom JV and Flexjet contract which is spread over 15 years. So you know, you can't sort of align the period of a backlog increase one to one with revenue generation year 1.

Greg Konrad, Jefferies

Perfect. And then maybe just given on the civil side, you know, you talked about the US little bit, but just given most of the training or most of the revenue in 26 is coming from training. Can you maybe just talk about, you know, regionally where you're seeing the biggest areas of, of strength within Civil Aviation?

Constantino Malatesta, Interim Chief Financial Officer

Yes, so I think for in terms of in terms of by region, I would say, you know, America's would be probably our weakest region right at the moment and Asia's probably our strongest because of all the, I guess all the things that you that you probably inferring in your question. You know, there's a lot of new airlines, a lot of growth in in some of our customers and in particular in some of our customers, we're seeing some good growth Business aircraft, I would say relatively, relatively stable. I mean we are expecting some improvement and utilization in business aircraft, but nothing, nothing outrageous. So I think you know, you know, training demand is pretty strong across the board, but of course the US is the one which is a little bit more, a little bit more muted for us.

Greg Konrad, Jefferies

Thank you.

Operator

Once again, any analysts with a question should press * then one. Our next question is from Tim James with TD Collins. Please go ahead.

Tim James,TD Collins

Thanks very much for taking my call. Good morning. Just one question, Marc, you're highlighting the great growth outlook now for Canadian defense spending, you know, doubling as you mentioned by 2032. You know, CAE already has just a great presence and a lot of very strong contracts in Canada. Can you talk about and maybe it's early, but any, anything you can say in terms of what that big pickup in defense spending could mean in terms of additional opportunities for CAE and what those might look like if you have any kind of sense for that at this point?

Marc Parent, President and Chief Executive Officer

Well, I can only give directional and you know, you just look at what I talked about in terms of doubling of the size or the expenditure of the defense budget in Canada or the over the next few years. I mean, I feel very, very good that that's going to translate into significant growth, you know, for CAE on top of the already very significant level of order intake and actually revenue that we're generating right now on contracts in Canada. And you know, we're, I think we will get our, what I would say there just before there, because we, we actually literally are a strategic partner and that those are their word strategic partner to the Government of Canada as they want to operationalize the acceleration of defense spending in Canada. You know, and when you think about what militaries do, you know, when they're not in conflict and hopefully you're never in conflict, but what do militaries do? Well, basically they train. They train, that's all they do, train, train, train. So obviously that's what we do. So you can, you could see right off the bat that any capability that they deploy, whether it's new aircraft, which new helicopters, new shippers, new submarines, all that is going to require very significant and realistic training. So as Canada's strategic partner, you know, I think we were going to continue to do very well in that market in Canada.

Tim James,TD Collins

OK, great. Thank you. Great.

Andrew Arnovitz, Senior Vice President, Investor Relations

Well, operator, I think we'll bring the call to a close. I want to thank all participants for joining us this morning and remind you that a transcript of the call and Q&A will be made available on CAE's website. Thanks very much and a good day to all.

Operator

This brings to a close today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.