CAE

REMARKS FOR CAE'S SECOND QUARTER FISCAL YEAR 2023

November 10, 2022

Time: 2:00 p.m.

Speakers:

Mr. Marc Parent, President and Chief Executive Officer

Ms. Sonya Branco, Executive Vice President, Finance, and Chief Financial Officer

Mr. Andrew Arnovitz, Senior Vice President, Investor Relations and Enterprise Risk Management

<u>Andrew Arnovitz, Senior Vice President, Investor Relations and Enterprise Risk Management</u>

Good afternoon, everyone, and thank you for joining us today.

Before we begin, I'd like to remind you that today's remarks, including management's outlook and answers to questions, contain forward-looking statements. These forward-looking statements represent our expectations as of today, November 10, 2022, and accordingly are subject to change. Such statements are based on assumptions that may not materialize and are subject to risks and uncertainties. Actual results may differ materially, and listeners are cautioned not to place undue reliance on these forward-looking statements. A description of the risks, factors, and assumptions that may affect future results is contained in CAE's Annual MD&A available on our corporate website and in our filings with the Canadian Securities Administrators on SEDAR at www.sedar.com and the U.S. Securities and Exchange Commission on EDGAR at www.sec.gov.

On the call with me this afternoon are Marc Parent, CAE's President and Chief Executive Officer, and Sonya Branco, our Chief Financial Officer.

After remarks from Marc and Sonya, we'll open the call to questions from financial analysts. At the conclusion of that segment, we'll open the lines to members of the media.

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.

We had strong performance in the second quarter, led by double-digit growth in Civil and sequentially better results in Defense. We also delivered another quarter of double-digit revenue growth in Healthcare with higher profitability. We continued to secure CAE's future with nearly $1.3 billion in total orders for a record $10.6 billion adjusted backlog and 1.30 times book-to-sales ratio.

In **Civil**, we made excellent progress converting our large opportunities pipeline into $751 million of orders, resulting in a 1.48 times book-to-sales ratio. This is especially impressive considering that revenue is 40 percent higher than last year. Orders include long-term training agreements with airlines and business aircraft operators, including a new 15-year pilot training and operations agreement with Qantas -- one of the world's most renowned airlines, and like CAE, a name synonymous with safety. We also secured training agreements with Virgin Australia, JetSmart Airlines, DHL Air UK, and American Airlines. Demand for full-flight simulators was robust with 18 sales in the quarter, bringing our year-to-date tally to 29. Since the end of the quarter, we've sold another 5 full-flight simulators, for a total of 34 sales since the start of the fiscal year.

Civil's financial and operational performance was also strong in the second quarter with double-digit growth across all metrics. We delivered 10 full-flight simulators in the quarter and average training centre utilization was 66%, up from 53% last year. This reflects the air traffic recovery in select regions and a measure of summer seasonality. Commercial aviation training demand in the Americas continued to be very strong, while Europe was seasonally lower on a sequential basis. In Asia, the reopening of Japan has been a positive catalyst, but the region overall remained well below pre-pandemic levels due to the ongoing travel restrictions in China. In business aviation, training demand continued to be robust throughout our network, reflecting a high level of pilot training to support business aircraft flight activity, which has shown signs of stabilization at approximately 20 percent above pre-pandemic levels.

In **Defense**, as we've been saying for some time, the earliest sign of our progress toward a larger and more profitable business, is order intake. Testament to that, this past quarter marks another step in the right direction. We booked orders for training and mission support solutions valued at $500 million for 1.13 times book-to-sales, which marks the fifth consecutive quarter this ratio has been above one and situates us with a book-to-sales ratio of 1.33 times on trailing twelve-month basis. We're now sustaining higher order intake, replenishing our backlog with new and more profitable Defense contracts.

Defense orders this quarter reflect our capabilities across all five battlespace domains. In the air domain, we signed a contract with Piaggio Aerospace for a P.180 Avanti full-flight simulator for the Italian Air Force, and we expanded our relationship with Lockheed Martin for system trainers and modifications involving C-130 platforms. A key tenet of our strategy is to develop strategic relationships with platform OEMs, and these agreements, in addition to our recently announced MOU with Boeing for global collaboration, are notable signs of progress.

In the land domain, we expanded our capabilities with a prototype development award under the U.S. Army Soldier Virtual Trainer (SVT) contract. A component of the Synthetic Training Environment SVT continues the expansion of synthetic training environments with a platform to empower soldier-led training. Defense also won a program in the sea domain with the Platforms and Systems Training

Contract to support the Royal Australian Navy (RAN). This program is strategically significant in the context of Australia's defence modernization priorities in light of geopolitical tensions in the Indo-Pacific region. Under a 5-year agreement, we'll be supporting the future training transformation of RAN mariners across four sea platforms -- on-site, in port, and at sea. We're leveraging our experience training mariners worldwide, including the U.S. Navy on multiple naval aircraft platforms, bridge training for the Littoral Combat Ship, and the U.S. Army Maritime Integrated Training System. In the space and cyber domains, we received additional awards from our key Space & Missile Defense customer along with cyber technology updates on our core platforms and systems from various customers within the U.S. Department of Defense. Our unique combination of experience, digital technology, and subject matter expertise also provided new opportunities this quarter with strategic customers for prototype development. They include an authorization from the Air Force Research Lab to develop and demonstrate innovative, mission-effective, unmanned air vehicle capability to assist with manned-unmanned teaming, along with an aviation mission planning prototype for a sensitive customer; both are U.S. National Defense priorities and leverage capabilities across CAE's business units.

Our financial performance for Defense in the quarter improved sequentially, consistent with our expectations. This performance is a result of our heightened operational focus in the face of the challenges we highlighted last quarter, namely the prevailing supply chain and labour headwinds, and order delays, all of which are pervasive across the defence sector and broader economy.

With that, I'll now turn the call over to Sonya who will provide additional details about our financial performance. Sonya?

<u>Sonya Branco, Executive Vice President, Finance, and Chief Financial Officer</u>

Thank you, Marc, and good afternoon, everyone.

Consolidated revenue of $993.2 million was 22% higher compared to the second quarter last year. **Adjusted segment operating income** was $124.7 million, compared to $90.7 million in the second quarter last year. And, quarterly **adjusted net income** was $61.5 million, or 19 cents per share, compared to 17 cents in the second quarter last year. We incurred restructuring, integration and acquisition costs of $22.6 million during the quarter, relating mostly to the L3Harris Military Training and AirCentre acquisitions.

Net cash provided by operating activities this quarter was $138.0 million, compared to $30.9 million in the second quarter of fiscal 2022. **Free cash flow** was $108.4 million compared to $19.4 million in the second quarter last year. The increase was mainly due to higher cash provided by operating activities and lower investment in non-cash working capital. CAE usually sees a higher level of investment in non-cash working capital accounts during the first half of the year and tends to see a portion of these investments reverse in the second half.

Capital expenditures totaled $68.6 million this quarter, with approximately 80 percent invested in growth, to specifically add capacity to our Civil global training network to deliver on the long-term training contracts in our backlog.

Income tax expense this quarter was $14.5 million, for an effective tax rate of 24%, which is higher than our annual outlook of 22%, which remains our expectation going forward.

Our **Net debt** position at the end of the quarter was approximately $3.2 billion, for a net debt-to-adjusted EBITDA of 4.17 times at the end of the quarter. We continue to expect net debt-to-adjusted EBITDA of below 3 times by the middle of next fiscal year.

Now turning to our segmented performance...

In Civil, second quarter revenue was up 40% to $507.2 million, compared to the second quarter last year, and adjusted segment operating income was up 60% to $104.4 million vs. the second quarter last year, for a margin of 20.6%. Our stronger year-over-year Civil performance was mainly due to higher training network utilization and simulator deliveries. We also integrated AirCentre into our results, which represented approximately 7% of Civil revenue in the quarter.

In **Defense**, second quarter revenue of $442.4 million was up 6% over Q2 last year. Adjusted segment operating income was $18.4 million for the quarter, down from $26.7 million in the second quarter last year. The revenue growth stems from a higher level of activity on programs, while the lower adjusted segment operating income reflects higher costs associated with supply chain and labour shortages, partially mitigated by our cost reduction initiatives.

And in **Healthcare**, second quarter revenue was $43.6 million, up from $34.9 million in Q2 last year, mainly due to increased sales of patient simulators. Adjusted segment operating income was $1.9 million in the quarter compared to a loss of $1.3 million in Q2 of last year.

With that, I will ask Marc to discuss the way forward.

Marc Parent, President and Chief Executive Officer

Thanks, Sonya.

The strength we saw during the second quarter gives us the confidence to reaffirm both our fiscal year 2023 outlook and long-term targets.

Our outlook for **Civil** remains strong, with its industry-leading positioning enabling us to grow significantly through the commercial aviation market recovery and beyond. Over the last two years, we expanded our reach and capabilities to better serve our customers, while significantly improving our cost structure. We expect the rate of Civil's commercial aviation training recovery to continue to be driven in large part by the eventual easing of remaining travel restrictions, especially in Asia where China remains a large component of any global recovery scenario. A potential reopening in China, would also be expected to lead to further recovery in full-flight simulator sales. On the macroeconomic front, we're watching the global energy situation closely – in particular in Europe with respect to operating costs, which have already increased across our network, and the potential for impacts on travel demand.

In business aviation, the consensus view at the recent NBAA conference was highly positive, and we continue to see strong demand for pilot training. In response to market demand, we have new training capacity coming online to include our new business aviation training centre in Las Vegas, which opened last month, and Singapore, which begins operations this month.

For the second half of the fiscal year, we expect Civil to grow faster than it did in the first half, and to be weighted more to the fourth quarter. We expect to deliver a higher number of full-flight simulators in the fourth quarter and to have a higher number of simulators, or SEUs, come online in our training network. In addition to continuing to grow our share of the aviation training market and expanding our position in digital flight services, we expect Civil to maintain its leading share of full-flight simulator sales and to deliver more than 45 full-flight simulators to customers worldwide. This is up from our previous outlook for 40.

In **Defense**, our sequential growth, paired with the significant bookings and improved backlog we are experiencing, gives us confidence for stronger near-term performance. In the last two years, Defense has become the world's leading, pure-play, platform agnostic training and simulation business. We're well positioned to address larger, more profitable and more comprehensive programs across all five battlespace domains. We're closely aligned with national defence priorities focused on near-peer threats and the increased need for digital, immersion-based synthetic solutions. We're uniquely positioned in this regard, being able to draw directly from CAE's innovations in the commercial aviation simulation and training market. Defence represents a secular growth market for CAE, as the sector is in the early stages of what we believe will be an extended up-cycle, driven by geopolitical realities and increased commitments to defence modernization and readiness.

The earliest indications of our success have been orders, leading to us build a more profitable backlog. We're bidding more and we're bidding larger, and what I see ahead is highly encouraging with a pipeline of multiple $100 million-plus programs, and a number of $1 billion-plus programs that we're bidding over the next three years. As we replenish our backlog, we expect Defense will strengthen in the next couple of years to a low double-digit percentage adjusted segment operating income margin profile. Currently, active bids and proposals awaiting customer decisions stand at approximately $8 billion, which is nearly double the amount outstanding three years ago.

Looking to the remainder of the fiscal year for Defense, we expect the current widespread macroeconomic headwinds including supply chain and labor challenges to persist for some time and that order delays will continue to be a factor. We're focused on execution, and we're confident in our expected stronger second half performance, which we expect to be substantially weighted to the fourth quarter. Underlying this view is our expectation for select delayed program awards to come to fruition and that we'll be able to execute on programs in backlog. We also expect to partially mitigate these headwinds with internal cost reductions and efficiencies, which are ramping up toward the end of the fiscal year.

And in **Healthcare**, we see potential for more value creation as it gains share in the healthcare simulation and training market and continues to build on its growth momentum and increased profitability.

In terms of our **capital allocation priorities,** we've concluded a heavier-than-usual inorganic growth investment cycle, which spanned the last two years as we seized opportunities in a disrupted market to enable CAE to become a bigger, stronger, and more profitable company for the future. We're now concentrating on organic investments that are made in lockstep with customer demand. We're also focused on reducing leverage, and as Sonya indicated, we're confident our net debt-to-adjusted-EBITDA ratio will decrease to below three times by the middle of next fiscal year, which at that time, will further increase our financial flexibility. CAE's management and Board of Directors are also focused on reinstating and prioritizing return of capital to shareholders on a timely basis, which is a cornerstone of our main capital allocation priorities.

In summary, the overall strength that we saw in the quarter and our current expectations for the balance of the year, are what allow us to reaffirm our outlook for mid-twenty percent consolidated adjusted segment operating income growth this fiscal year, and to maintain our long-term target of a three-year EPS compound growth rate in the mid-twenty percent range.

With that, I thank you for your attention. We're now ready to answer your questions.