CAE Inc. FY2023 Q3 Financial Results – transcript of analyst call
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C O R P O R A T E   P A R T I C I P A N T S

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C O N F E R E N C E   C A L L   P A R T I C I P A N T S

Konark Gupta
Scotiabank

James McGarragle
RBC Capital Markets

Kevin Chiang
CIBC

Cameron Doerksen
National Bank Financial

Fadi Chamoun
BMO

Tim James
TD Securities

Benoit Poirier
Desjardins Bank Capital Markets

Matthew Lee
Canaccord Genuity

Fai Lee
Golan Brown

Anthony Valentini
Goldman Sachs

Kristine Liwag
Morgan Stanley

Stéphane Rolland
La Presse Canadienne

PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the CAE third quarter conference call. Please be advised that this call is being recorded. I would now like to turn the meeting over to Mr. Andrew Arnovitz. You may now proceed, Mr. Arnovitz.

Andrew Arnovitz, Senior Vice President, Investor Relations & Enterprise Risk Management

Good afternoon, everyone. Thanks for joining us on the call. Before we begin, I will 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, February 14, 2023, 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 and the U.S. Securities and Exchange Commission on EDGAR.

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 & Chief Executive Officer

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

We had strong results in the third quarter, driven by Civil's double-digit growth, Defense's sequential improvement, and Healthcare's increased profitability. We also ensured our path to future growth by securing over $1.2 billion in total order intake for a record $10.8 billion backlog and 1.22 times book-to-sales ratio.

In Civil, we booked $713 million of orders from a large opportunities pipeline, resulting in a 1.38 times book-to-sales ratio. This is especially noteworthy accomplishment, considering this is on revenue that's 33% higher than last year. Orders include long-term commercial aviation training agreements with GOL Airlines and MESA Airlines, and a multi-year business aviation training agreement with Delux Public Charter.

We also made excellent progress with our flight operations software solutions, with notable agreements including a five-year contract with Ethiopian Airlines for our next-gen crew and operations manager solution suite, and since the end of the quarter, an agreement with Frontier Airlines for our next-gen operations solutions. Demand for full-flight simulators continued to be strong with 14 sales in the quarter, bringing our year-to-date total to 43.

Civil's financial and operational performance was also strong in the third quarter, with double-digit growth and near-record margins. We delivered nine full-flight simulators in the quarter, and average training center utilization was 73%, up from 60% last year. Commercial aviation training demand continues to be strongest in the Americas, followed by a seasonal uptick in Europe and then Asia, which has improved with the ongoing easing of travel restrictions in China. In business aviation, training demand continues to be robust throughout our network, reflecting a high level of pilot training to support business aircraft flight activity, which continues to exceed pre-pandemic levels.

In Defense, the leading indicator of our progress toward a larger and more profitable business is order intake. This quarter, we booked orders across domains for training and mission support solutions valued at $477 million for a 1.05 times book-to-sales ratio. This marks the sixth consecutive quarter that this ratio has been above one, and situates us with a book-to-sales ratio of 1.25 times on a trailing twelve-month basis.

Notable orders in the air domain include the provision of a flight training device and maintenance and logistics support for the Royal Canadian Air Force's CH-149 Cormorant search-and-rescue helicopter, the continuation of aircrew training on the KC-135 Stratotanker and C-130 Hercules for the United States Air Force, and international flight training device upgrades for the F-16 fighter jet and CH53 heavy-lift transport helicopter.

In the land domain, we were awarded funding for our Joint Terminal Control Training Rehearsal System, which builds on the success of our previous funding award for a new virtual training capability for soldiers to the US Army on the Soldier Virtual Trainer prototype contract. We also booked orders in the space and cyber domains, highlighted by the proliferation of CAE's solutions for distributed, networked and cybersecure mission training via the U.S. Air Force's SCARS program. And since the end of the quarter, we booked orders in the sea domain with our ongoing work with Lockheed Martin on the Canadian Surface Combatant ship program.

Defense also continued to build on its foundation of U.S. Army support with the successful competitive re-compete for the U.S. Army Aviation Fixed-Wing Flight Training Program, which involves the provision of comprehensive initial and recurrent training for more than 600 U.S. Army and U.S. Air Force fixed-wing pilots annually at the CAE Dothan Training Center in Alabama.

The approximate total value of the base contract and options is US$250 million, with a period of performance through 2032. This was awarded to us with an effective date commencing in our fourth quarter and accordingly, will be reflected in our next quarter order intake.

Also involving U.S. Army aviation, our prime partner on the U.S. Army's Future Vertical Lift, Bell Helicopter, was awarded the FLRAA program, which will field the V-280 Valor tiltrotor to eventually replace the long-serving UH-60 Black Hawk helicopter. Pending protest resolution on this award, CAE will support Team Valor by delivering a range of training devices, solutions, and courseware for Bell's family of systems.

We've continued to place a strong focus on our operations and asset optimization in the face of the ongoing macroeconomic challenges impacting the defense industry as well as the broader economy. And as a result of these efforts, our financial performance for Defense in the quarter improved sequentially, and was largely in line with what we expected.

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

Sonya Branco, Executive Vice President, Finance and CFO

Thank you, Marc, and good afternoon, everyone. Consolidated revenue of $1,020.3 million was 20% higher compared to the third quarter of last year. Adjusted segment operating income was $160.6 million, compared to $112.7 million in the third quarter last year. Quarterly adjusted EPS was $0.28, compared to $0.19 in the third quarter last year.

Adjusted EPS this quarter includes an approximate $0.02 positive impact as a result of gains on the reversal of impairment of non-financial assets following their repurposing and optimization. We incurred restructuring, integration, and acquisition costs of $4.9 million during the quarter, relating mostly to the AirCentre acquisition, and this also includes the $9.8 million impairment reversal.

Net cash provided by operating activities this quarter was $252.4 million, compared to $138 million in the preceding quarter and $309.6 million in the third quarter of fiscal 2022. Free cash flow was $237.7 million compared to $108.4 million in the preceding quarter and $282.1 million in the third quarter last year. The sequential increase was mainly due to a lower investment in non-cash working capital and higher cash provided by operating activities, while the decrease compared to the third quarter last year was mainly due to a higher investment in non-cash working capital, which was partially offset by higher cash provided by operating activities.

Capital expenditures totaled $63.4 million this quarter, with approximately 75% 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 $17.1 million, for an effective tax rate of 18%. The income tax rate was impacted by restructuring, integration and acquisition costs this quarter, and excluding these costs, the income tax rate was 19%.

Our net debt position at the end of the quarter was approximately $3.1 billion, for a net debt-to adjusted EBITDA of 3.74 times at the end of the quarter. This 43-basis-point improvement from last quarter puts us solidly on track to meet our targeted leverage ratio of below 3 times net debt-to-adjusted EBITDA by the middle of next fiscal year.

Net finance expense this quarter amounted to $48.8 million, which is up from $41.3 million in the preceding quarter and $34.5 million in the third quarter last year. Approximately 70% of our debt obligations are fixed rate, and the increased finance expense largely reflects the impact of higher interest rates on our variable rate debt instruments. For now, we're assuming a go-forward quarterly run rate for this expense in the range of the current quarter.

Now turning to our segmented performance. In Civil, third quarter revenue was up 33% to $517.4 million, compared to the third quarter last year, and adjusted segment operating income was up 58% to $131.4 million versus the third quarter last year, for a margin of 25.4%. Our strong year-over-year Civil performance was mainly due to higher training in our network utilization and the integration of AirCentre into our results, which represented approximately 10% of Civil revenue in the quarter.

In Defense, third quarter revenue of $452.5 million was up 6% over Q3 last year. Adjusted segment operating income was $25.4 million for the quarter, down from $32 million in the third quarter last year. The revenue growth stems from FX translation and a higher level of activity on programs, while the lower adjusted segment operating income reflects higher costs associated with inflation, supply chain disruptions and labor shortages. This was partially mitigated by a reversal of impairment on an intangible asset following repurposing and optimization and cost reduction initiatives.

And in Healthcare, third quarter revenue was $50.4 million, up from $32.1 million in Q3 last year, mainly due to increased sales of patient simulators and center management solutions. Adjusted segment operating income was $3.8 million in the quarter, for an adjusted segment operating income margin of 7.5% compared to a loss of $2.7 million in Q3 of last year.

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

Marc Parent, President & Chief Executive Officer

Thanks, Sonya. The strength that we saw in the third quarter gives us additional confidence in both our fiscal year 2023 outlook as well as our long-term targets.

We're excited about Civil's prospects as we build on our industry-leading position with the most innovative training and critical operations support solutions, and we expect to see significant growth during and beyond the ongoing global aviation market recovery. We anticipate continued strong growth in commercial aviation training as flight capacity rises to meet travel demand, and as mobility restrictions abate in China, which remains a key driver for airlines mainly operating in Asia Pacific but also worldwide.

In business aviation, flight activity has remained above pre-pandemic levels and we continue to see strong demand for business aviation pilot training. We have been and will continue to deploy training capacity in lockstep with demand in this segment of the market.

We continue to expect Civil’s performance to be strongest in the fourth quarter, with a mix involving about twice as many full-flight simulator deliveries as in the third quarter, which gets us to our estimate of 45-plus deliveries for the fiscal year. We also have more simulators coming online in our global training network which makes for a larger base of revenue. We've done very well with full-flight simulator sales year-to-date, and we expect to maintain that momentum, winning our fair share.

In Defense, despite the macroeconomic headwinds, order delays, and potential U.S. budget complexities, which are expected to extend into the next fiscal year, our continued sequential growth, along with positively trending bookings and backlog renewals, adds to our confidence in our multi-year view.

Defense represents a secular growth market for CAE, and we believe the sector is in the early stages of an extended up-cycle, driven by geopolitical realities and increased commitments to defense modernization and readiness. We're now sustaining higher order intake, replenishing and renewing our backlog with new and more profitable defense contracts and we expect this trend to continue and for Defense to strengthen over a multi-year period to a low double-digit percentage segment operating income margin profile.

We're bidding more and we're bidding larger, 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. We're highly focused on execution, and as we look into the remainder of the current fiscal year, we expect further sequential improvements for Defense in the fourth quarter.

And in Healthcare, we are on a path to accelerate value creation by gaining share in the simulation and training market, and driving top and bottom-line growth. We have a strong team and I expect to see their positive momentum to continue.

Our capital allocation priorities are unchanged, with a focus on organic investments that are made in lockstep with customer demand. We're on track to meeting our leverage target by the middle of next fiscal year, which at that time, will further increase our financial flexibility. The CAE management and Board of Directors are also prioritizing returning capital to shareholders in a timely manner, which is a key aspect of our capital allocation strategy.

In summary, the strength of our performance in the quarter and our current expectations for the balance of the year allows us to reiterate our outlook for mid-20% consolidated adjusted segment operating income growth this fiscal year. We're also reiterating our long-term target of a three-year earnings-per-share compound growth rate in the mid-20% range.
With that, I thank you for your attention. We're now ready to answer your questions.

Andrew Arnovitz, Senior Vice President, Investor Relations & Enterprise Risk Management

Operator, we'll now take questions from financial analysts.

QUESTION AND ANSWER SESSION

Operator

Sir, I thank you. And once again on the phones before we begin, to ask a question you can press "1" "4" on your telephone keypad. You will hear a three-tone prompt to acknowledge your request. If your question has been answered or you'd like to withdraw your resignation it is "1" "3".

We'll now proceed with our first question on the line from Konark Gupta with Scotia Bank. Please go right ahead with your question.

Konark Gupta, **Scotia Bank**

Just wanted to ask you on the Civil side first. The margins are already back to the pre-pandemic levels here in the fiscal Q3. Are you expecting the margins to be nearing the peak? Or would you expect further upside as Asia comes back?

Marc Parent, President & Chief Executive Officer

If I look at this quarter, as I said in the remarks, we had quite a favorable mix this quarter and as I've said in the past, that can be an important factor to margin. I remember answering that question in Q1 when it was going the other way.

If you look at next quarter, we're going to have a lot more full flight simulator deliveries, which will play a role to margins because inherently, product sales -- although profitable -- are not as profitable as training. So as we're deploying a lot of training, although we still see a very strong performance in Civil, I wouldn't expect to see a high margin in the fourth quarter.

I always like to be surprised; I certainly don't expect it. But long term, look, at the end of the day, as the market comes back, as you said, with Asia coming, I'm quite encouraged by what I see in Asia Pacific, and it's been the longest drag on recovery. We're continuing to see the positive effects in our travel recovery. We're seeing in terms of utilization in our training centers. But it's going to take some time.

As we saw in Europe and in Americas, it takes a while for it to pick up. I think we're several quarters away from being fully back in my opinion. But make no mistake, when I look at fiscal '25 and beyond, I think we're seeing the pieces here of a total recovery taking shape. So if you factor that plus all the cost savings that you're seeing flow through our results, I think we can expect that margins can continue to increase over the longer term.

Konark Gupta, Scotia Bank

Okay. That's good color, Marc. And as a kind of a follow-up. There was a recent announcement, I guess, by one of the U.S. airlines, given they are struggling with pilot shortage, they're trying to reduce the number of hours required for pilots to train on turbine engine. What does that really mean for CAE?

Marc Parent, President & Chief Executive Officer

Well, look, I think I'll leave that to the regulators, but everybody is always focused very much on safety. So at the moment, I would tell you that we barely meet the demand that's out there, and we're in growth mode. So to me, I don't see that being a factor one way or another to results of CAE.

Operator

We'll go to our next question on the line is from James McGarragle with RBC Capital Markets.

James McGarragle, **RBC Capital Markets**

So on the Defense margins in the quarter and some of the long-term targets the team established at the Investor Day, are you able to help quantify the bridge between those two? So I know the supply chain is kind of unknown at this point and really anyone's guess as to when that improves. But are you able to talk to the items that you do have a line of sight into over the next few quarters, such as potentially certain low-margin business rolling off, any high-margin contracts upcoming or specific cost savings related to L3H cost synergies?

Marc Parent, President & Chief Executive Officer

Well, I think it's all of the above. Look, as we said before, we're basically doing very well on order intake. You can see like 6 consecutive quarters now of book-to-bill is higher than 1. You have a trailing book-to-bill over the last 12 months of 1.25, which points to strong growth.

And the important thing about that is the Defense team -- with Dan Gelston at the helm -- is signing contracts that are accretive to a long-term goal. So what you are seeing here is that these orders don't happen overnight. And it depends if they're products or services, products contributing to results faster. But those new contracts are replacing contracts in our backlog, some of them that are drag programs that have been very much impacted by the headwinds that we faced the supply chain, as we said, as you mentioned, and on labor. And in some cases, although we've done very well on order intake, not all the orders are created equal in terms of their timing.

But look, we have a pretty good line of sight of those factors. So that's what allows me to reaffirm not for Q4, for sure, and then having enough line of sight of how we're doing in terms of abatement of those factors to give the optimism that I have for its continuous sequential improvements all through next year along the way to our long-term target of double-digit profitability.

James McGarragle, RBC Capital Markets

I also wanted to ask a question on Civil and the potential impact of a slowdown in Europe. I know pilot training is regulated and that is insulated from macro to a certain extent, but can you talk to how your conversations with customers in Europe are evolving given some of the macro headwinds in the region? And any steps your team is taking to prepare for a potential slowdown in that region?

Marc Parent, President & Chief Executive Officer

Well, I think I would tell you is that we're not seeing a slowdown from where we are at. And certainly, in Europe and in the Americas, definitely. We're seeing things pick up, as I mentioned in our previous question in Asia Pacific. But at the moment, we're in growth mode and we're forecasting to be in growth mode for at least the consumable future.

So obviously, what people talk about risk of recession in Europe, it certainly bears watching, particularly as a result, if it's faced with a potential energy crisis, which really hasn't occurred, materialized. But look, we're watching it, but we're certainly not seeing it, and we're not forecasting it anytime soon. at least as a result of CAE.

Operator

We've got our next question on the line is from Kevin Chang with CIBC.

Kevin Chiang, CIBC

Congrats on a good fiscal Q3 here. Maybe just on Defense. In your outlook, you mentioned there's a little bit of uncertainty here with U.S. government budget appropriation issues. I'm just wondering, do you see that primarily impacting, I guess, the timing of awards being allocated? Or does that also impact because I believe you are pursuing some cost recovery initiatives with the government on just given how inflation has played out here. Do these appropriation issues also will impact the timing of some of those cost recovery initiatives for you?

Marc Parent, President & Chief Executive Officer

Look, on the second part of your question, in regards to that specific point in the recent DOD budget, and I would tell you, we influenced this not in any significant way. Funding was granted specific to address inflation. That's public. And I can tell you, we're working with our customers to address the inflationary items that have been -- and I've mentioned this on previous calls -- that have definitely been a factor. And that results in our submitting requests for what's called equitable adjustments or REAs. We've submitted quite a bit, but it's early in the process.

Well, I can tell you, we have received some small adjustments, nothing material, I would say. And so going back to what I mentioned with regards to budgets being approved and disruptions there, we could see a prolonged continuous resolution environment in Defense.

So look, that has a potential for delays to new program starts because if you're in that kind of environment, you can't have any new program starts. So we're watching that. But I would tell you that even with that factor, it may affect the exact timing, but it doesn't change my view with regards to sequential growth next year in Defense.

Kevin Chiang, CIBC

And maybe my second question here. You've alluded to now the past couple of quarters looking to return cash to shareholders, and it sounds like you might be in a position to provide more details the next fiscal year. But is there a framework we should be thinking about? Like are you looking at a targeted payout ratio on the dividend or in terms of buyback?

Are you looking to return to what you were doing pre-pandemic? Is there any framework you can share with us? Or is it being contemplated at the Board level still?

Sonya Branco, Executive Vice President, Finance & CFO

Yes. I think as we said, the first priority is really to de-lever. And we saw really good progress in Q3, bringing down the leverage ratio by almost half a turn and continue to be on track to our guidance. So then we believe we'll be in a better position to consider the return of capital to shareholders. I think it's too soon to speak about a framework or form at this point.

Kevin Chiang, CIBC

Actually just one last question for me. Just given the sequential increase in full flight simulator deliveries expected in the fiscal Q4, any risks around supply chain or all the parts and things that you need to build and deliver those all, I guess, all in-house now and you're just kind of ready to deliver this stuff by quarter end here?

Marc Parent, President & Chief Executive Officer

Well, you can never say zero risk because you never know what can hit you. But all those simulators are at customer sites as we speak. So they're built. So it's not an issue. As you know, we're pretty experienced at delivering and certifying full-flight simulators. So barring some factor that I would qualify almost as an act of God, I feel pretty good about us getting those simulators certified. And as I said, part shortages are no longer a factor when you consider there's about 6 weeks left in the year.

Kevin Chiang, CIBC

Thank you very much. Congrats again.

Marc Parent, President & Chief Executive Officer

Sending a shout-out to the hundreds of people that we have working in customer sites around the world doing that as we speak. And I applaud them because they're the heroes making this happen.

Operator

We'll get to our next question on the line is from Cameron Doerksen with National Bank Financial.

Cameron Doerksen, National Bank Financial

I wonder if you can just talk a little bit about the progress that you're seeing with the AirCentre business. You've sort of indicated a couple of new airline awards here. It sounds like you've got some kind of a new next-gen solution there. Just sort of talk about what the investments required, what kind of progress you're making with customers on that new solution and where the business I guess has recovered to at this point?

Marc Parent, President & Chief Executive Officer

Well, look, the business is doing exactly what we thought it would do; it may be even slightly ahead at this very moment. We are very happy about what's happening there. I'll let Sonya talk about where we are in terms of our investments later. I would say it's largely in line with what we had anticipated when we announced the acquisition.

Look, I'm very excited about this. We talked about what our ambitions were for what is an adjacent market for us. And this is playing out. You remember that we have an extremely large overlap of customers between our training and simulator business, and this flight services business. And we continue to see very high receptivity of our traditional customers to us being in this market.

And it comes at a time that we're seeing as airlines ramp up capacity now, it's obviously very challenging times. And you can see from recent evidence that airlines in many cases, have really outgrown their technology infrastructure, and they need to reinvest. So you can be assured that we're engaged with all of our customers to help them as they shape their technology and needs of the future, you can be sure of that.

So I fully expect that we're going to be part of the solution over time. And it's not going to be a near-term P&L impact because at the moment, we're focused on integration. And remember, in this kind of business, it's kind of like an ERP implementation – it can take extended periods of time. But once you have them, you have them for an extended period of time as well.

So look, I'm very happy with the solutions. The next-gen solution is all about software as a service versus legacy on-premises. We have a pipeline. That pipeline is growing. It's going to take time, but I'm very happy about how we're progressing here.

Sonya Branco, Executive Vice President, Finance and CFO

Yes. I'll just add on the investment part. So to elaborate on what Marc said, we're seeing the ramp up. We're seeing it flow through. That represents about 10% of Civil's revenue this quarter. So that's very good. In terms of investments, we never laid out the exact amount, but it's in the tens of millions, and has started since the acquisition and is part of the investments that you see through the results.

Cameron Doerksen, National Bank Financial

If I could squeeze in a second one, just quickly on the Defense side. Now that Canada has formally signed a contract for the F-35, can you update us on, I guess, what your expectation is for the training solution for that and how you think you're positioned for that?

Marc Parent, President & Chief Executive Officer

Well, I think we're well positioned, obviously, because I mean, that's what we do. We do it around the world every single day. We talked about the, for example, F-35, that we won another F-16 contract recently. So we know how to do this. We've done an F-18 and majority of fighters out there in the world.

I personally and members of my team are in discussions with all levels of government in Canada and with the customers in the United States. We've met with the F-35 joint program office who provide management support for the F-35 program. And we're confident that they'd be highly receptive to a proposal by Canada to embed additional training and simulation capacity in Canada's domestic F-35 program. And I was encouraged by the fact that when the Canadian government announced the F-35 contract, they announced that simulation-based training will be done at Canadian airforce bases like Cold Lake.

So I think it's a natural for CAE to be involved here. And look, I think this is a generational moment for Canada's national security. I think Canada has chosen well in terms of the fighter jet for men and women in , and for Canada's national sovereignty.

There are many Canadian jobs and Canadian innovations at stake here. Canada needs to seize this opportunity of the investment we're making here. And we can't afford to miss this unique opportunity to create and protect the next generation of aerospace jobs in Canada; that's key as well. We're part of that today, and I fully expect us to be part of that tomorrow.

Operator

Our next question on the line is from Fadi Chamoun of BMO.

Fadi Chamoun, BMO

Marc, if business aviation flight hours end up being down 5%, 10% this year because of the economy or in the next 12 months, I guess, is there levers within CAE based on kind of the recent acquisitions you've done and your positioning on (inaudible) program to continue to grow in that side of the business?

Marc Parent, President & Chief Executive Officer

Absolutely, Fadi. Look, the fleet is still growing. With the level of new pilot demand, we have trouble meeting it now. You know I'm a pilot. I can see it myself: at our training centers, I won’t exaggerate, we can't find a parking space 7 days a week. So I'm not overly concerned about a slight drop in the flight hours.

I mean we're seeing a very, very hot market for business aviation training. We're continuing to add capacity. Our Las Vegas training center has just come online. So has Singapore. Savannah will be online next year. We have a training center in Orlando opening up with our JV partner, Directional Capital, which is our Simcom training center.

And I can tell you that we have demand spoken for coming into those training centers. So I'm not too worried about a drop in flight hours that could occur.

Fadi Chamoun, BMO

The second follow-up question is really on Defense. I mean, we have six quarters now of expansion in terms of the order levels and the outlook is positive for that to continue.

When do we start to really experience this kind of demand momentum into the margin with a greater kind of influence. Is this more of a fiscal '25 story or fiscal '24 story? Just trying to understand the trajectory of how these headwinds from supply chain and mix in the backlog kind of come off versus returning to a more normal margin in that segment.

Marc Parent, President & Chief Executive Officer

Well, look, it's going to be steady progress. That's what I see. The headwinds that we see--I mean as you can well imagine, we're not sitting on our hands not doing anything about it. We're doing something about it, but it takes time.

It takes time to hire people. It takes time for them in the Defense sector to get the proper security clearances that we need for them to be able to execute on some of the programs we have. This is going to take several quarters to abate but it has been getting better every quarter.

We know what parts we need on the contracts that we have. But when you get new contracts, you need new parts, okay? Now we are get better at forecasting those things, but it's still an issue because the supply chain is not as fast as it once was. And at the same time, we're factoring potential delays in orders because of things like I talked about, the U.S. defense procurement.

But make no mistake. I'm seeing steady improvements in our business in terms of how we're managing it. We have a good level in terms of the execution of our programs and the level of contingency in those programs that we have; we execute them well. As you know, there was a factor in Q1. And I mentioned that it has not happened in 17 years. I don't see that happening again, not with the rigor that we put into it.

So look, I expect when you talk about when we recover back to low double digits, look, we're on that road, Fadi. And I think that you're going to see that over the next couple of years.

Operator

We'll get to our next question on the line is from Tim James with TD Securities.

Tim James, TD Securities

My first question, I guess, I just want to return actually to that last topic, Marc, I'm just wondering if you could comment on or characterize any particular pinch points in the supply chain that are more problematic than others?

Any sort of particular parts or aspects of the supply chain that are a little bit more problematic. And I'll open it up to either your civil business or your defense business.

Marc Parent, President & Chief Executive Officer

Well, I think I'd start out by saying it hasn't really been a factor on our Civil business and mainly because we've done a good job over the years to design a product that is highly repeatable, highly standard. And our teams in global sourcing, for example, in operations have done a very good job forecasting and being able to obtain those parts. So I think that's been the case.

In Defense, look, I think the issue is, I wouldn’t characterize any single part. It's basically longer lead times on many parts. That's what really is the factor here. Obviously, we've had issues like everybody has on the electronic parts, those kinds of things. But today, it's really longer lead times on inventory of many parts.

And what that does, it's not only the fact that you missed the part itself is it's the fact that in the meantime, you either can't progress on that contract or you're having to do workarounds and workarounds is inherently inefficient you have maybe people being idle or installations they're having to work around them therefore causing delays.

So all those things cause inefficiencies that weigh down on our margins. And it has, I would say, a double effect because traditionally, we are able to execute contracts and get ahead of ourselves to execute the programs faster and therefore, generate efficiencies. And we're in the contrary situation right now.

And the same effect with labor, you don't necessarily have the software engineers that you need because of some of the factors I talked about the time to get them the time to get them basically certified with the right clearances they need. Now that is getting better because obviously, demand in the high-tech market for software engineers specifically has cooled.

So we are a bit of a benefit of that. We're seeing that. But it's going to take a few quarters for that to abate to the extent that we get back to the margins that we have targeted in our long-term Defense business.

Tim James, TD Securities

My second question, I'm just wondering if there are any areas of your civil business, either in the business aviation side or the commercial side, where you think pricing is particularly strong as we sit here today due to the incredible sort of demand conditions and how quickly air travel has ramped up. And therefore, pockets of pricing that could come under pressure when we get past this very strong ramp-up period?

Or do you think as some of the other areas that still remain weak, such as China, et cetera, maybe sort of make up for any of that potential moderation in pricing?

Or do you not see any kind of particularly strong pricing at this point?

Marc Parent, President & Chief Executive Officer

Well, I think I'd start by saying that in our Civil business, in a large part, let's say, the training business is long-term training contracts. And that's our specific strategy, as you know. And they typically have fixed percentage or CPI-based escalators that are built in. So that has a moderating effect going up and going down, right? So you don't really see big spikes.

We have been able to pass on some of the inflationary aspects that we've seen over time when contract renewals come up. And don't forget, our vision always has been, and it's the way we operate is to delight our customers. And the correlator to that is we don't gouge them when the market is going up, and they don't begrudge us a fair margin. So I think all of that comes out to say that I'm quite comfortable in the outlook that is given with regards to margins in Civil going forward.

Operator

Our next question on the line is from Benoit Poirier from Desjardins Bank Capital Markets.

Benoit Poirier, Desjardins Bank Capital Markets

Just based on your comments on the recovery trajectory for Defense margin, would it be fair to say that high single digits next year might be a bit too optimistic and mid-single digits would be more realistic?

Marc Parent, President & Chief Executive Officer

I'm not going to give you the specifics at this time, Benoit, only to say, as I said before, that we're working through the headwinds and that we're going to continue to see improvement going forward on a sequential basis, for sure.

Benoit Poirier, Desjardins Bank Capital Markets

Okay, that is great. And looking at Healthcare, capital employed was mostly flat versus last quarter. how should we expect capital employed to evolve or to be deployed going forward for Healthcare? And do you see any opportunities to monetize these assets given the rich valuation and all the spin-off that we've seen recently, Marc?

Marc Parent, President & Chief Executive Officer

Well, look, I think in Healthcare, we're focused on translating the great top line success that we're seeing. I mean you look at the revenue this quarter and which is historical, it's translating into bottom line. I'm sure you've noticed that. We're quite happy with that; six quarters in a row of pretty strong growth at the top line, two consecutive quarters positive SOI.

And we have a great team. We have Jeff Evans at the helm of the business. He's built a very strong team; no exaggeration, we have the strongest team we've ever had in Healthcare, and they're hard at work, they're winning in the market, and that's what we're focused on. And Healthcare is self-funding. So that's the trajectory that we're on, Benoit.

Benoit Poirier, Desjardins Bank Capital Markets

Okay, that is great. And with respect to Asia Pacific, where are you in terms of recovery versus pre-pandemic level? Are you back to halfway through, below or still above?

Marc Parent, President & Chief Executive Officer

Well, I wouldn't say halfway through, look, how would I characterize it? We're in the low 70% utilization in that approximately right now. It does have seasonal variations. I'll give you some maybe data points.

In terms of simulator deliveries or orders typically prior to the pandemic, we typically sell maybe six to eight full-flight simulators a year to China, okay? And I would say over the last couple of years, we've only sold two or three in total. So that gives you an idea in terms of simulator sales.

The more near-term recovery comes in training. And that mainly because we don't have any training centers in China, but it's all the training centers that we have in the region. Of course, we have a lot of training centers in the region. The anchor customers that we train in those regions, a good proportion of their flights are in and out of China. So as that recovers, we see the utilization in our training centers ramp up. I expect that to materialize over the next few quarters as the recovery takes hold.

Operator

We'll go to our next question on the line from Matthew Lee with Canaccord Genuity.

Matthew Lee, Canaccord Genuity

On the Civil side, when I think about new pilots coming through (inaudible) training, is that a higher-margin program and a margin benefit than usual annual pilot training? And maybe you can quantify kind of the growth you're seeing in (inaudible) just given how many pilots need to be trained right now?

Marc Parent, President & Chief Executive Officer

It's actually a lower-margin business than when we look at our mix, it's on the lower end. When we look at what drives increasing capacity in our training center network and it's part of our offering to airlines, which is very important. Airlines are looking for pilots. And CAE has the largest network of pilot training centers in the world. And don't forget, we don't take people off the street. I mean we only establish training programs for the airlines themselves.

So it's an important part of the offering that we give the airline as a complete solution, but if I take it by itself, it would be, if you like, lower than the average margin that we get in our Civil business.

Matthew Lee, Canaccord Genuity

And then on the Defense side, you pointed out delayed orders coming to fruition as a potential margin driver. Are those contracts naturally high margin with more product in the mix? Or is there another reason those orders in particular are positive for margins?

Marc Parent, President & Chief Executive Officer

I wouldn't say all, because sometimes, it'll go strategic, but the great majority of the contracts that we're signing and we're bidding today are accretive to our objective of low double-digit margins in our Defense business.

Operator

Our next question on the line from Fai Lee with Golan Brown.

Fai Lee, Golan Brown

It's Fai here. Marc, you mentioned that CAE has submitted a request for equitable adjustments. And I'm just wondering if you can comment on the process, for example, are there set deadlines for the customer to respond back to you? Is it a negotiated process? What happens if the customer says no? Do you have like an ability to appeal the decision?

Marc Parent, President & Chief Executive Officer

Well, it's case by case. It depends. What I mean by that is sometimes, the request for equitable adjustment may be submitted to the government itself and sometimes to an intermediary, which we contract with on behalf of the government. So again, case by case.

We do have to, as you might expect, we do have to make our case and a lot of documentation goes into that, but we have that documentation. We are putting those cases forward. There is no specific timeline for recovery.

As I said, one thing that encourages me very much is and as I said previously, we had a lot to do with it ourselves; our government affairs people in Washington did a very good job on this that in recent DoD budget, there was funding specifically granted to address inflation in the industry. So we're working with our customers and working to prepare our own claims with regards to that increased budget. So but again, there's no timing on that, but I fully expect some of that will come to fruition.

Fai Lee, Golan Brown

And would you describe the requests or the response has been reasonable or conversations? Like they haven't been unreasonable, have they?

Marc Parent, President & Chief Executive Officer

No, I don't think anybody is being unreasonable, but you have to make your case, which takes time. But yes, we have made our case. We have simulators that we're literally delivering across the country; in one contract it's about 180 transport trucks with armed guards crossing the United States that were bid when gas was $2 a gallon, but we all know that not gas is not $2 a gallon anymore. So you could just imagine that just on that basis alone, you say, well, let's be fair here. That's not exactly a 2% kind of natural growth in the contract and they're receptive to that kind of thing.

Fai Lee, Golan Brown

Fai Lee: And then my second question, back in Q1, one of the charges that you took was for a Navy contract, I believe it was the CNATRA program that expired and has been extended? And if I remember correctly, you were hoping to have it recontracted in better terms. I'm just wondering, has that happened? Has it been recontracted on better terms? Or are you still waiting?

Marc Parent, President & Chief Executive Officer

We're still waiting on that one. And we can't really talk about that. I mean, in the end it's a contract that we've submitted the bid and they haven't selected anybody as far as I know.

Operator

And we'll proceed to our next question on the line from Anthony Valentini with Goldman Sachs.

Anthony Valentini, Goldman Sachs

I'm looking at the utilization rates in the 73% here in the quarter, comparing that back to pre-pandemic levels, and it looks like you guys are actually at or in some cases above where you were.

I'm curious in terms of how you guys think through like the capital allocation process of how high that number can go, right? Because I think there needs to be some sort of slack in the system. And when you get to that number, whatever it is, how you think through putting new simulators into your network, if that makes sense.

Marc Parent, President & Chief Executive Officer

Yes. Look, the short answer is, as we said in the remarks, we deploy capital in lock step with demand. You can well imagine because we're the market leader here and have been for a long time, both in simulators and simulator-based training, we know the market very well, and we know our customers very well, and we're in constant dialogue with that both in the airline sector and the business aviation sector.

So we have a pretty good and informed idea of how much demand will be required because remember, it's a regulated market. You can just look at how many flights people expect to make, how many deliveries are coming out of the OEMs, and you will be able to establish what is the demand requirement across the world approximately. So that's how we deploy it.

And in terms of what is the practical capacity, look, I'll tell you, I was at our training center in Minneapolis about three weeks ago, where our anchor customers are some of the largest regional carriers in the United States, like Endeavor, for example, and I can tell you, our training centers there are operating above 100%. And teams are doing a great job.

So when you talk about practical capacity, you can get up there and you can sustain it when you need to. And that's I believe you me to support the training of regional carriers in the United States right now, they need us to be operating at that level. So we can do it. So there's elasticity there.

Now in practical reasons, when we define 100% for airlines, get a little bit detailed here, but that's 6,000 hours a year, which is 16 hours a day. So that's what we consider a practical limit. But again, we're doing higher than that. So there's flat. If the demand is there, that's what we do.

And when we get to those kind of levels, well, guess, what? In Minneapolis, there was a bunch of nice tractor trailers or backhoes building 2 new simulator bays in Minneapolis, while I was there because clearly, demand is there. And we secure long-term contracts; we're not speculative on how we deploy that capital.

Anthony Valentini, Goldman Sachs

I'm curious how long the lead times are once you decide you need to add a simulator to a facility? How much time does it take for you guys to build that sim and then deliver it to be up and running?

Marc Parent, President & Chief Executive Officer

It depends on where it's going and that's the big factor. But typically, if we make a decision on an airline a typical simulator -- one that we’ve built before -- it's typically between 12 and 14 months, I would say.

Anthony Valentini, Goldman Sachs

Okay, helpful. Last one for me on Defense. You highlighted future vertical lift. I'm curious, and I'm sure you have hundreds if not thousands of contracts but where does that kind of rank in terms of the large programs that you have? And should we be thinking through that contracts being negotiated in the old strategy or the new one, which is that kind of targeting double-digit percentage margins?

Marc Parent, President & Chief Executive Officer

The new one. Does that answer the question?

Anthony Valentini, Goldman Sachs

Yes. And then just how in terms of rank how (inaudible) versus the other?

Marc Parent, President & Chief Executive Officer
It's a large contract. But I said in the remarks that we have a lot of contracts that we're bidding in a $100 million range, and we have a lot of contracts in the $1 billion range over the next three years. This is one of the ones that clarified in the second category of $1 billion without getting specific.

So it's a large opportunity over time, but it's not the only one. So it doesn't disproportionately affect my view on the fortunes we would have next year. It's important, but it's definitely not the only one.

Operator

Our next question on the line is from Kristine Liwag from Morgan Stanley.

Kristine Liwag, Morgan Stanley

I just want to follow up on pilot shortage and like the bigger picture. I mean pre-COVID pilot shortage was already an issue and then the mandatory retirements coming up in the U.S. will likely exacerbate the issue.

I mean, when you look at the programs that your customers are undertaking, like the (inaudible) and things like that, how much of these actions solve like the bigger shortage problem? And if not, what should they be doing to support industry growth? Because it just seems like there's not enough urgency in terms of actions that they should be taking. So I just want to get an idea of how much you think that is kind of solved with actions today? And if not, how do you think that gets resolved?

Marc Parent, President & Chief Executive Officer

Look, I think it's going to take time. It's going to take investment; pilots are not the only issue that are facing the industry right now. I mean it's been exacerbated by the fact that the industry was extremely finely honed before the pandemic, then we went back to (inaudible). And so we've been gradually rebuilding that industry every part of it.

So pilots are one part of it, an important part, one we play in a very big way. And we're doing our part by helping our customers. We've been deploying new demand in terms of flight school activity. We've been signing core contracts with them. We're operating our training centers as mentioned on the previous answer at levels that are unheard of, at least certainly in the United States right now.

So look, I think it's going to take time, it's going to take investment. And that's why I think in terms of our business, I think it's going to be a good business for a period of time. I'm quite confident in next few years in civil aviation.

Kristine Liwag, Morgan Stanley

Yes. It just seems like there's no urgency. If I could sneak a second one on--

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Marc Parent, President & Chief Executive Officer

--Sorry to interrupt you, I would tell you that if you were talking with some of the airline CEOs that I talk to, you would feel that urgency. Guaranteed. But sorry, go ahead, Kristine.

Kristine Liwag, Morgan Stanley

If I could ask another one on M&A. When you look at what you've acquired over the years, part of that was attributed to your success and some of your competitors basically ceding their territory back to you. If such opportunities exist out there, would you consider levering up the balance sheet even more today?

I mean some of those assets--are there even any assets available for sale that you could consolidate like you've done in the past decade? And if so, to what leverage are you comfortable?

Marc Parent, President & Chief Executive Officer

Sonya won't let me. No, seriously. We're focused on deleveraging right now. We don't see any gaps in our portfolio. We did very well during the pandemic to play offense during the downturn. As I think you've seen we've done quite a nice job of deleveraging in this quarter. I see that continuing along in the past that we said that we'll get to a level of three.

So look, we never pass up the opportunity that would be that's too good to pass. But I think we've done a good job. And we're focused on deleveraging right now, looking to start returning cash to shareholders and continue to be the one priority is to continue to grow in lockstep with demand and that's largely inorganic.

Andrew Arnovitz, Senior Vice President, Investor Relations & Enterprise Risk Management

So operator, that's all the time we have for financial analysts. I'd now ask you to open the queue to members of the media, if there are any questions.

Operator
Certainly. As a reminder for the media, if you would like to ask a question you may do so now by pressing "1" "4" on your telephone keypad. Once again, it is "1" "4" for any questions or comments you may have. And we do have a question queued up from Stéphane Rolland, La Presse Canadienne. Go right ahead. La parole est à vous.

Stéphane Rolland

Oui, bonjour M. Parent. Merci de prendre le temps de prendre mes questions. Je voulais vous poser une question sur le segment de la défense car je vois les résultats s'améliorent, depuis les difficultés de l'été dernier, puis depuis le dernier trimestre. Je me demandais un peu si vous pouvez donner un peu plus de détails sur quelles sont les actions que vous avez prises pour améliorer la situation et quels défis, en fait qu'est-ce qu'il reste à faire, quelle partie du travail il reste encore à faire.

Marc Parent, President & Chief Executive Officer

Merci pour la question. La chose la plus importante qui contribue à l'augmentation de nos résultats, c'est que depuis les six derniers trimestres - donc disons les 24 derniers mois – on a un ratio de commandes à nos livraisons qui sont en haut d'un. Si on regarde juste les derniers douze mois, on est à 1.25. Donc, disons 25% de plus de commandes qu'on a de ventes. Ce qui veut dire qu'on est en train de non seulement grandir la business en termes de *revenues*, mais en même temps ces nouveaux contrats qu'on signe, on les signe avec une marge de profit supérieure à celle qu'on a dans notre carnet de commandes existant. À mesure qu'on exécute ces nouveaux contrats, qu'on remplace ceux qu'on a, ça contribue à l'augmentation des marges dans notre business de défense. Ça c'est le facteur le plus important que je vous dirais.

Stéphane Rolland

Peut-être, vous en avez parlé un peu avec les analystes … au sujet de la vigueur de l'industrie aérienne, vous en avez fait mention à quelques reprises. Est-ce que tu peux me donner des exemples de la résilience de l'industrie en ce moment qui vous font croire que l'industrie est résiliente en ce moment?

Marc Parent, President & Chief Executive Officer

Vous parlez du secteur de l'aviation civile en général?

Stéphane Rolland
Oui, c'est ce que j'avais compris.

Marc Parent, President & Chief Executive Officer

Ce qu'on voit … je vais commencer par l'aviation d'affaires. L'aviation d'affaires, on voit une très forte demande en termes d'activités dans ce secteur ce qui est très bon pour nous, parce que nous, on a une business très très importante dans l'entrainement des pilotes de l'aviation des affaires. Les niveaux de vols et donc la demande de pilotes dans le secteur de l'aviation des affaires est supérieure, considérablement supérieure, au niveau que c'était avant la pandémie. Et moi, je suis convaincu que ça va continuer dans le futur. Ça c'est l'aviation d'affaires.

Si on regarde maintenant le secteur de l'aviation commerciale, les gens ont recommencé à voler, beaucoup. On le voit d'ailleurs avec l'engouement pour le transport aérien, ça cause des problèmes, quand on voit qu'il y a des tempêtes, des choses comme ça, l'industrie peine à remplir la demande. On voit que les gens recommencent à voyager. L'activité commerciale est forte partout à travers le monde. On le voit avec le secteur qui est en montée, ça se traduit pour nous des entrainements de pilotes considérablement en hausse dernièrement. On est encore loin. On n'est pas aussi haut qu'on était avant la pandémie. Mais, vraiment le seul endroit qu'il reste, où le niveau d'activité est plus bas qu'avant la pandémie, c'est en Asie. Ça, c'est vraiment la Chine. La Chine avec le fait que la Chine était fermée jusqu'à récemment, mais maintenant avec le relâchement de la politique zéro Covid en Chine, on voit que les vols recommencent à reprendre ce qui va faire que l'industrie aérienne en Asie va remonter parce que la plupart des compagnies aériennes en Asie ont beaucoup de vols qui vont en Chine, donc ça va se traduire par une activité accrue dans nos centres de formation. Tout ça, ce sont des facteurs qui font en sorte que je suis très positif sur l'activité aérienne civile donc sur notre business pour les années à venir.

Stéphane Rolland

Une dernière question de mon côté. Vous avez bien parlé de la chaine d'approvisionnement. Au sujet de la rareté de la main-d'œuvre, est-ce que vous avez toujours des défis? Est-ce que c'est difficile de recruter en ce moment?

Marc Parent, President & Chief Executive Officer

On en a. On voit ça surtout, je vous dirais dans nos activités militaires aux États-Unis. Parce qu'il y a deux facteurs. Il y a la rareté de la main-d'œuvre elle-même, les ingénieurs de logiciels pour citer juste un exemple. Il y a la complexité additionnelle du fait qu'ils ont besoin d'une classification de sécurité élevée donc ça prend un temps qui est non négligeable à avoir. Donc, c'est un facteur qui contribue. À Montréal, on a encore beaucoup de postes ouverts surtout pour le personnel technique, 500 plus à Montréal, en ce moment. Mais, on a de bonnes universités à Montréal donc on réussit à les remplir. Ce n'est pas un facteur sur notre croissance, en ce moment, mais ça pourrait le devenir si on ne continue pas à le faire, mais je ne l'entrevois pas.

Stéphane Rolland

Ok. Et peut-être une question de suivi par rapport à ça. Dans le secteur manufacturier, Manufacturiers et Exportateurs du Québec s'inquiète à cause du manque de main-d'œuvre, on délocalise les activités ailleurs, pas pour des raisons de coûts, mais de main-d'œuvre. Est-ce que c'est quelque chose que vous envisagez avec tous les postes qui sont ouverts à Montréal? Est-ce que c'est un défi pour vous?

Marc Parent, President & Chief Executive Officer

Non. Non, nous autres, on est très verticalement intégrés à CAE. C'est la stratégie qu'on a. Je suis très content de la main-d'œuvre qu'on a ici à Montréal et de nos fournisseurs au Québec. Je ne vois aucun changement. On réussit à avoir des nouveaux employés qui sortent des écoles techniques. Je suis très content des nouveaux employés qui travaillent chez nous.

Stéphane Rolland

Merci de prendre les questions des médias. C'est très apprécié. Bonne journée.

Andrew Arnovitz, Senior Vice President, Investor Relations & Enterprise Risk Management

Operator, if there are no more questions from members of the media I want to thank all participants, investors, and members of the member. (foreign language spoken)

I would like to remind everyone that a transcript of today's call will be posted on CAE's website. Thank you.

Operator

Thank you very much. And that does conclude the call for today. We thank you for your participation and ask you disconnect your lines. Have a good day, everyone.
