CAE

REMARKS FOR CAE'S THIRD QUARTER FISCAL YEAR 2022

February 11, 2022

Time: 1:00 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, February 11, 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 will take questions from financial analysts and institutional investors. Following the conclusion of that Q&A period, we will open the call to questions from members of the media.

Let me now turn the call over to Marc…

<u>Marc Parent, President and Chief Executive Officer</u>

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

I'm very pleased with our third quarter performance—especially in the context of a still-challenging global environment. We delivered double-digit growth, strong free cash flow, and we nearly doubled order intake compared to the third quarter last year. On a consolidated basis, we grew revenue by 15 percent, before the contribution of our ventilator humanitarian initiative last year. We also grew adjusted segment operating income by 16 percent and delivered $0.19 of adjusted earnings per share. Underscoring the cash generative profile of our business, we delivered a healthy $282 million of free cash flow. We also made excellent progress on the order front, building even more forward momentum with nearly $1.4 billion in orders for a book-to-sales ratio of 1.62 times and a backlog of $9.2 billion.

In **Civil**, we had strong performance with double-digit growth in training and adjusted segment operating income, and we had margins break above 20 percent for the first time since the start of the pandemic. Third quarter average training centre utilization was 60%, up from 50% last year, and was seven percentage points higher than last quarter. This is an impressive result considering the wide-ranging disparity in commercial flight activity and training demand across regions, and because Omicron began to spread in the last month of the quarter. As we've been seeing since the start of the fiscal year, demand in the Americas was by far the strongest, while Europe and especially Asia Pacific continued to lag the recovery, leaving significant headroom to a return to pre-pandemic levels. In business aviation, training demand was robust, reflecting the high level of flight activity, which was above 2019 levels in the U.S. and Europe.

We had very strong order activity in Civil in the third quarter, booking training solutions contracts valued at $753 million for a 1.93 times book-to-sales ratio, including 19 full-flight simulator sales. This is in sharp contrast to the 11 FFS orders we booked for the entire prior fiscal year and brings our FFS sales for the first nine months to 33. Since the end of the quarter, we signed orders for another four, bringing the year-to-date tally to 37. Consistent with the more advanced air travel recovery in the Americas, over 60% of the year-to-date total are from customers in that region and include FFS orders from all major U.S. carriers, including orders for multiple FFSs from some of the largest U.S. airlines this quarter. Our airline customers in the Americas have been adding back flight capacity and actively ramping up pilot hiring. In order to secure the training capacity they require, they've been working with CAE as their training partner of choice, entering new long-term training agreements and acquiring additional simulators. We think this makes for a compelling preview of what an eventual broader global market recovery holds for CAE.

Notable training contracts for the quarter include five-year extensions of commercial aviation training agreements with Endeavor Air and Avianca, a nine-year commercial aviation training agreement with Norwegian as well as five-year business aviation training agreements with Global Jet Luxembourg, XO Jet and Vista Jet.

In **Defence**, we also had double-digit growth in the quarter with the contribution of L3H MT, and as we expected, we surpassed the $30 million mark in adjusted segment operating income. I'm especially pleased with our order intake this quarter which totaled $593 million for a 1.39 times book-to-sales ratio and a $4.6 billion backlog. We seized on the opportunity of the temporary relaxations in pre-Omicron COVID-19 restrictions, and as a result, our international book-to-sales ratio was above one for the first time since the start of the pandemic.

In addition to the positive book-to-sales, we're also seeing more conversion on our Defence strategy to pursue multi-domain training and mission support solutions. Orders to date include competitive prime awards, recompetes and contract expansions across all five domains (Air, Land, Sea, Space and Cyber). In the Air domain, we strengthened our international presence with the German Air

Force's competitive selection to provide Ab Initio pilot training, replacing the 60-year incumbent. Along with this new live flight training program, we also expanded our relationship with the US Navy's Chief of Naval Air Training (CNATRA) by adding T-45 live flight training to our instructional services contract. Beyond live flight training, we were awarded a 19-year, base plus options, contract from an Australian customer to provide integrated support and training on a range of strategic platforms. Other contract expansions include four task orders on our Simulator Common Architecture Requirements and Standards (SCARS) single award IDIQ, as the US Air Force accelerates the integration and standardization of approximately 2,400 simulators across 300 locations.

Since the end of the quarter, we've made additional notable progress to broaden our position beyond our core Defence Air, Land and Sea programs by winning our first competitive prime contracts in Cyber and Space. We were selected by Canada's Department of National Defense (DND) to expand cyber intrusion detection capabilities on the Innovation for Defence Excellence and Security (IDEaS) program, and we were awarded our first prime simulation contract in the Space domain with a key U.S. customer. These strategic Cyber and Space prime contracts, along with our first U.S. Intelligence Community (IC) competitive prime win in the second quarter, are great examples of how we're building our Defence business for the future by establishing it as the world leading platform agnostic, training and simulation pure play, ensuring mission readiness by integrating solutions across all five domains.

Finally, in **Healthcare**, we delivered our fourth consecutive quarter of double-digit year over year revenue growth (excluding ventilators), as we ramp up our reenergized organization with a clear focus on achieving greater scale. We launched updates to expand the feature set and functionality of some of our main product solutions, including LearningSpace, our simulation centre management system, and Vimedix, our ultrasound education platform. We also introduced 11 new on-demand online digital courses featuring virtual simulation in collaboration with the British Columbia Institute of Technology.

With that, I'll now turn the call over to Sonya who will provide additional details about our financial performance. I'll return at the end of the call to comment on our outlook. Sonya?

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

Thank you, Marc, and good afternoon everyone.

We delivered double-digit, year over year growth and strong free cash flow during the third quarter, notwithstanding the ongoing challenges of the pandemic. Our performance reflects CAE's resiliency and the strength in some of our end markets, as well as our excellent progress to expand our reach and lower our cost structure.

Consolidated revenue of $848.7 million was 2% higher compared to the third quarter last year and was 15% higher, excluding $93.5 million of revenue in the third quarter last year from a contract to provide the Canadian government with ventilators as part of our COVID-19 humanitarian initiatives. **Adjusted segment operating income** was $112.7 million, compared to $97.2 million last year. And, quarterly **adjusted net income** was $60.7 million, or 19 cents per share, compared to 22 cents in the third quarter last year. We incurred restructuring, integration and acquisition costs of $47.2 million during the quarter, related to L3H MT and the enterprise-wide restructuring program underway.

Cash provided by operating activities this quarter was up 32% to $309.6 million, compared to $234.8 million in the third quarter of fiscal 2021. **Free cash flow** was also higher at $282.1 million compared to $224.0 million in the third quarter last year. The increase was mainly due to a lower investment in non-cash working capital, partially offset by cash payments of approximately $38 million related to the integration and acquisition costs of our recently acquired businesses and costs associated with our restructuring program.

Growth and maintenance capital expenditures totaled $76.9 million this quarter, mainly for growth, and specifically to add capacity to our global training network to deliver on the long-term exclusive training contracts in our backlog. Our growth CAPEX is directly linked to our opportunities to invest incremental capital with attractive returns and free cash flows. With several attractive market-led expansion investment opportunities on the horizon, we continue to expect total capital expenditures to be more than $250 million in fiscal year 2022.

Income tax expense this quarter was $2.6 million, for an effective tax rate of 8%, compared to an effective tax rate of nil for the third quarter last year. The income tax rate was impacted by restructuring, integration and acquisition costs this quarter, and excluding these costs the income tax rate this quarter was 20%, which is the rate we used as a basis to determine adjusted net income of $60.7 million and adjusted EPS of $0.19.

Our **Net debt** position at the end of the quarter was approximately $2.3 billion, for a net debt-to-capital ratio of 36.5%. And net debt-to-adjusted EBITDA was 3.23 times at the end of the quarter. We continue to expect interest expense of about $35 million as a quarterly run rate going forward.

Now turning to our segmented performance...

In Civil, third quarter revenue was $390.1 million vs. $412.2 million in the third quarter last year and adjusted segment operating income was up $21.4 million over the third quarter last year to $83.4 million, for a margin of 21.4%. This highly improved performance was driven by higher training utilization predominantly in the Americas, and including our interest in joint ventures, Civil training services revenue was approximately 10% higher compared to the third quarter last year. The higher revenue in training was offset by lower products revenue with the delivery of seven FFSs this quarter compared with 10 last year. The lower number of scheduled deliveries in the quarter was expected and is consistent with our outlook for approximately 30 for the year.

In **Defence**, third quarter revenue of $426.5 million was up 42% over Q3 last year. This includes $127.9 million from the integration of L3H MT in our financials. We indicated on the last call that we expected segment operating income to cross into the $30 million range, and indeed it did by reaching $32.0 million for the quarter, including $19.6 million from the acquisition, for a margin of 7.5%. The organic Defence business grew sequentially this quarter but remained lower compared to last year because of prior period COVID-19 impacts on orders and program execution, particularly internationally, which have been persistent since the onset of the pandemic.

And in **Healthcare**, third quarter revenue was $32.1 million, down from $120.9 million in Q3 last year on a statutory basis, but was up 17%, excluding the ventilator contract last year. Adjusted segment operating loss was $2.7 million in the quarter compared to an income of $12.9 million in Q3 of last year. The decrease from last year was mainly due to the contribution from the ventilators in the prior year, and COVID-related labour disruptions and higher costs. We are also running a higher level of SG&A expenses to help accelerate top-line growth, with a view to sustainable scale and profitability.

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

<u>Marc Parent, President and Chief Executive Officer</u>

Thanks, Sonya.

As we look to the period ahead, we continue to see a clear path to emerge from the pandemic a larger, more resilient, and more profitable CAE than ever before. Testimony to that, we're already delivering stronger financial performance, expanding and optimizing our position, and booking substantial orders.

Pandemic-related headwinds may persist for some time, including supply chain disruptions, employee and customer absenteeism due to COVID-19 infections, operational constraints imposed by local authorities, and intermittent border restrictions. The emergence and rapid spread of the Omicron variant this past December has extended the timeline to a broad global recovery but has not changed our positive view of CAE's potential as our end markets eventually open more broadly and we emerge from the pandemic.

In **Civil**, a greater desire by airlines to entrust CAE with their critical training and digital operational support and crew management needs, higher expected pilot demand, and strong growth in business jet travel demand are enduring positives underpinning a secular growth market. The global recovery continues to be narrowly led by the Americas, which means significant upside remains for a more global recovery, and we think the Americas provide a preview of the kind of demand to follow in other regions, when conditions permit. Since the end of the quarter, we've had to contend with Omicron-related employee and customer absenteeism; however, the Americas are still strongest, and we're currently seeing some increased demand for training solutions in Europe as COVID-related restrictions begin to ease and airlines plan for what they expect will be a more robust summer travel season and beyond. As an example, EasyJet just recently announced a drive to hire 1,000 new pilots over the next five years with CAE as their training partner of choice. Asia Pacific is currently the most challenging region with relatively low levels of flight activity and training demand as Omicron now makes its way through that region. Overall, since the end of the quarter, our training centres have been holding at about a 60% average utilization level, globally.

In business aviation, we remain bullish on the long-term and we believe the market is experiencing a structural expansion, with 3.3 million flights worldwide in 2021—the most on record for a single year. COVID-19 headwinds bear mentioning here as well, as Omicron quarantine requirements were disruptive to our schedule in January for both our customers and CAE instructors, but we look to be back on trend and we're still seeing strong demand for training, propelled by robust flight activity in the US and Europe. And in simulation products, we're encouraged by the higher projected delivery rates of new aircraft coming off manufacturers' production lines, as one of the main driver for FFS sales. We're seeing higher demand, as evidenced by this quarter's FFS order intake, coming mainly from customers in the Americas and Europe, and we expect to maintain our leading share of the market.

The unevenness of the global recovery is likely to continue for some time, but we're ultimately in an excellent position to benefit from the multi-year cyclical market recovery underway. We continue to expect strong growth in Civil for the current fiscal year overall.

In **Defence**, the paradigm shift from asymmetric to near-peer threat and a recognition of the sharply increased need for digital immersion-based, synthetic solutions across all five domains in national defence, are tailwinds that favour CAE's business.

Given the increasing relevancy of training and simulation, our Defence unit is also on a multi-year path to becoming a larger and more profitable business. We are currently focused on the successful integration of L3H MT and we are on track to fully realize the $35 to $45 million of cost synergies we laid out, by fiscal year 2024. The pandemic continues to make international opportunities slower to materialize, but this headwind is temporary, and we have a strong pipeline with some $6.2 billion of bids and proposals pending customer decisions. Our increased orders in the quarter puts Defence on the path to achieving over 1.0 times book-to-sales for the year for the first time in the last three fiscal years. Our U.S. Defence business was also impacted by pandemic-related employee absenteeism in January and it currently faces a temporary budgetary headwind on contract expansions and new program starts as a result of the Continuing Resolution. Defence is indeed managing through its share of ongoing challenges but we're moving in the right direction, and we remain confident that we'll deliver strong annual growth for fiscal year 2022.

And lastly in **Healthcare**, we're focused on achieving greater scale by gaining share in the simulation and training market, and we're targeting some of the largest pools of value like nursing. Supply chain disruptions and staffing shortages are a near-term headwind for this business too, but we continue to expect to deliver double-digit growth for the fiscal year, excluding the ventilator contract.

On the **ESG** front, I want to highlight that CAE was included in the 2022 Bloomberg Gender-Equality Index for the fourth consecutive year. This award recognizes that CAE is committed to support gender equality through policy development, representation and transparency. We're proud to continue building an inclusive workplace, every day.

In **summary**, we've been adeptly playing offence during this period of market disruption by investing organically and seizing on nine acquisitions to enhance our position and broaden our market reach. We've also strengthened CAE by permanently reducing our cost base across the enterprise. The timeline to a broad global recovery is more extended, but our actions and our performance to date give me even greater confidence that we are on the path to strong cyclical recovery and secular growth as our markets eventually open and we all emerge from the pandemic. We're delivering on what we said we would do, and I expect CAE to continue driving higher levels of profitability, on a significantly larger base of business, and with a post-pandemic capital structure that will allow us to sustain ample flexibility to further invest in our future. Our opportunity set continues to look very attractive, and I've never been as confident about CAE's future as I am today.

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

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

Operator, before we open the lines to questions, I want to highlight, that last month, Marc was honored with one of the world's most prestigious aviation awards, having been named Industry Leader of the Year by the Living Legends of Aviation. We're very proud of him and how this reflects positively on all at CAE. Please join me in congratulating Marc!

We would now be pleased to take questions from analysts and institutional investors.