CAE

REMARKS FOR CAE'S FOURTH QUARTER AND FULL FISCAL YEAR 2020

May 22, 2020

Time: 1:00 p.m.

Speakers:

Mr. Marc Parent, President and Chief Executive Officer

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

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

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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 for FY21 and answers to questions, contain forward-looking statements. These forward-looking statements represent our expectations as of today, May 22, 2020, 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…

Marc Parent, President and Chief Executive Officer

Thank you, Andrew, and good afternoon to everyone joining us on the call. I'll first discuss some highlights of the quarter and the year, and then Sonya will review the detailed financials and outline some of the measures that we've put in place to protect our financial position and preserve liquidity in the face of the pandemic. I'll come back at the end of the presentation to comment on our outlook.

We were leading CAE to what would have been yet another record year when the COVID-19 pandemic hit and unfortunately, it impacted us during what is normally our strongest quarter. More importantly is the risk this suddenly posed to people's wellbeing and our first response was naturally to ensure the health and safety of our employees and customers—and this continues to be our top priority.

We wasted no time assembling a COVID-19 pandemic taskforce and putting our business continuity plans in place. I am extremely proud of CAE's employees worldwide, who daily, through even the most extreme conditions, take to heart the continuity of our customers' most critical operations, and earn the privilege of being their training partner of choice.

What makes me even more proud is the way our employees went beyond the call of duty in the fight against COVID-19 by bringing forward the idea to develop a critical care ventilator. It took just 11 days for 12 CAE engineers and scientists to develop a prototype, and now some more than 500 CAE employees are delivering on a contract with the Government of Canada to manufacture 10,000 ventilators to help save lives. The CAE Air1 ventilator, as we've called it, is in the final stages of certification by the health authorities.

We're in the business of safety, after all; and this humanitarian gesture is a true testament to the kind of social impact that CAE and its employees have. It also underscores the Company's agility and our culture of innovation.

Now, turning to our results, notwithstanding COVID-19 impacting us during our biggest quarter, we still had a strong performance overall in fiscal year 2020, with double-digit revenue growth, 21% operating income growth, and 7% higher earnings per share. I'm especially pleased with our 98% conversion of net income to free cash flow, which underscores the cash-generative profile of CAE's world-leading training solutions.

In **Civil**, we exceeded our annual outlook, with 37% higher operating income and annual orders totaling $2.5 billion, including additional airline training outsourcings and 49 full-flight simulator sales. Civil finished the year with a record backlog of $5.3 billion. Again, this year, we delivered more than one million hours of training, underscoring CAE's position as the largest Civil aviation training company in the world.

In the fourth quarter specifically, Civil, booked orders for $469 million, including the sale of 12 full-flight simulators. Civil saw a significant decrease in training services demand as a result of the reduction in airline and business aircraft operations globally, and the disruption to the global air transportation environment. In addition to much lower demand, travel restrictions and local self-isolation measures worldwide resulted in several Civil aviation training location closures. By the end of the March quarter, 19 of our over 60 training locations had suspended operations, and a further 10 locations began operating at significantly reduced capacity. In addition to disruptions to our global training network, we also had to suspend the installation and delivery of Civil simulator products, and under local public directives, our

Montreal manufacturing plant suspended manufacturing of Civil simulators during the last week of March. Despite these disruptions, we still managed to deliver an otherwise impressive 56 Civil full-flight simulators for the year.

In Defence, we expected a strong fourth quarter in order to reach our annual outlook for modest growth, but it too was impacted by the pandemic. We achieved modest revenue growth, but we came up short on operating income, which was down 13%, mainly on lower than expected progress on program milestones, and delays securing new orders. A range of programs with defence and OEM customers globally saw project advancement delays due to travel bans, client access restrictions and supply chain disruptions. Also, we had delays to contract awards, as government acquisition authorities followed directives in their respective countries to shelter-in-place and eliminate travel. In the Middle East, the new realities brought about by the pandemic and low oil price has led work on certain programs to be halted and new contract awards to move to the right, with customers focused on their new fiscal realities and mitigating the pandemic.

Despite these headwinds, we still booked $1.2 billion of orders during the year, for a $4.1 billion Defence backlog, which gives CAE an additional measure of diversification. Key wins include a contract for KC-135 aircrew training services and simulator upgrades for the U.S. Air Force, and a contract to provide the German Navy with a comprehensive training solution for the NH90 Sea Lion helicopter and to upgrade and modify the German Army's NH90 full-mission simulators. For the quarter, we received Defence orders and contract options totaling $277 million. Notable wins include a contract with Leonardo to provide M346 training devices and upgrades, an order from BAE Systems to supply our CAE Medallion MR e-Series visual system, and an order from Babcock France to provide a Pilatus PC-21 full-mission simulator for the French Air Force.

And finally, **in Healthcare**, we were tracking expectations for double-digit annual revenue growth, when it too was negatively affected by COVID-19, as medical and nursing school customers came under lockdown protocols, and hospital customers focused attention on the healthcare crisis.

CAE Healthcare did, however, succeed to bolster its position during the year as the innovation leader in simulation-based healthcare education and training. It won the EMS World Innovation Award for CAE AresAR, the Microsoft HoloLens application for Healthcare's emergency care manikin. Healthcare also launched innovative products including new Anesthesia SimSTAT modules, screen-based simulation approved by the American Board of Anesthesiology for maintenance of certification credits; and multiple custom simulators for OEMs and leading medical device companies, including Baylis Medical and Edwards Lifesciences.

And on the humanitarian front, in addition to our ventilator initiative, Healthcare provided complimentary training seminars on how to prepare healthcare workers in the fight against COVID-19. We also launched simulation-based training solutions to train personnel in the safe practice of ventilation and intubation, which is key to saving lives. Additionally, we leveraged our global supply chain to supply some 600,000 N95 masks to the Quebec and Manitoba governments in support of front-line health workers.

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

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

Thank you, Marc, and good afternoon everyone.

In view of the pandemic-related challenges ahead, we implemented several flexible measures to protect our financial position and preserve liquidity, including a significant reduction of capital expenditures. Our current expectation is for approximately $50 million of CAPEX deployed in the first half of the fiscal year and we will assess the level of deployment as market conditions develop.

We are also significantly reducing R&D investments; and we have introduced strict cost-containment measures, salary freezes, salary reductions, reduced work weeks and approximately 2,600 temporary layoffs. We have since been able to recall approximately 1,500 temporarily laid-off employees in Canada through the Canada Emergency Wage Subsidy program, for which we must qualify on a monthly basis. We have also accessed and are working to access government support programs in other countries where we operate.

Other cash preservation measures we introduced, include a suspension of our common share dividend and share repurchase plan. Additionally, we are working with our defence customers to secure more favorable terms for milestone payments, as well as offer contract modifications to increase work scope and, working with suppliers, for extended payment terms.

CAE’s training operations are inherently, highly cash generative; however, the combination of sharply lower demand and the COVID-19-related disruptions to our operations are expected to result in negative free cash flow in the first half of the new fiscal year. Adding to this, we normally see an increase in non-cash working capital investments in the first-half. And, I would add that while collections are timely with Defence customers, we expect collections to be slower with Civil customers. Based on our current view, we expect to generate positive free cash flow in the second half as markets begin to inflect more positively.

Now looking at our results, consolidated **revenue** for the fourth quarter was down 4% to $977.3 million. Quarterly **net income before specific items** was $122.3 million, or 0.46 cents per share, which is also down 4% compared to 0.48 cents in the fourth quarter last year. As Marc noted, COVID-19 began to negatively impact our results during our biggest quarter. On average, we typically generate upwards of 20% of our annual operating income in the month of March alone.

For the year, consolidated revenue was up 10% to $3.6 billion, and **segment operating income before specific items** was up 21% to $590.4 million. Annual **net income before specific items** was $359.7 million, or $1.34 per share, which is up 7% compared to $1.25 last year. Specific items in fiscal 2019 include the costs from the acquisition and integration of Bombardier's BAT Business. Specific items in fiscal 2020 also include the impacts of Defence and Security's reorganizational costs and the impact of the goodwill impairment charge recognized in Healthcare.

We generated $185.1 million of **free cash flow** in the quarter and $351.2 million for the year, for an annual cash conversion rate of 98%, which is right in line with our annual average conversion target of 100%. During the year, we generated higher earnings which converted into higher cash provided by operating activities, which more than offset our higher investment in non-cash working capital.

Uses of cash involved funding **capital expenditures** for $84.0 million in the fourth quarter and $283.4 million for the year, mainly for the deployment of new simulators to our global training network in support of customer-led growth opportunities.

Other uses of cash included the distribution of $110.9 million in dividends for the year. In addition, we repurchased and cancelled approximately 1.5 million common shares under the NCIB program during the year, for another $49.6 million. In all, between dividends and share buybacks, CAE returned $160.5 million to shareholders during fiscal 2020.

Looking at capital returns, **return on capital employed**, before specific items and excluding the impacts of IFRS 16, was 10.9% compared to 11.6% last quarter and 12.9% last year.

Net debt was $2.4 billion at the end of March, for a net debt-to-total capital ratio of 47.8%. This compares to $1.9 billion or 43.9% of total capital at the end of last year. Since we adopted IFRS 16 effective April 1, 2019, net debt now also includes obligations under lease contracts which were previously accounted for as operating leases and therefore not included in debt. Excluding this impact, the net debt-to-capital ratio would have been 44.2% this quarter.

Subsequent to the end of the quarter, we concluded a new two-year, $500 million senior unsecured revolving credit facility, and expanded our receivable purchase program from US$300 million to US$400 million. These transactions provide us access to additional liquidity and further strengthen our financial position. All told, between cash and available credit we have upwards of $2 billion of liquidity, which we believe, in addition to the cash we expect to generate from operations, is a solid position to manage through the period ahead.

Income taxes this quarter were $26.9 million, representing an effective tax rate of 25%, compared to 13% for the fourth quarter of fiscal 2019. The tax rate in the fourth quarter last year would have been 20% before certain elements, and in the fourth quarter this year, the income tax rate before the goodwill impairment charge for Healthcare, would have been comparable at 19%.

Now turning to our segmented performance.

In Civil, fourth quarter revenue was up 1% year over year to $601.9 million. Operating income before specific items was up 26% to $153.6 million, for a margin of 25.5%. For the year, Civil revenue was up 16% to $2.2 billion and operating income before specific items was up 37% to $479.4 million for an annual margin of 22.1%. Double-digit organic growth and the successful integration of the Bombardier BAT business contributed to these record Civil results, notwithstanding the pandemic impact. The Civil book-to-sales ratio for the quarter was 0.78 times and for the year it was 1.14 times.

In **Defence**, fourth quarter revenue of $341.8 million was down 12% over Q4 last year, and operating income before specific items was down 21% to $40.2 million, for an operating margin of 11.8%. For the year, Defence revenue was up 2% to $1.3 billion and operating income before specific items was down 13% to $114.5 million, representing a margin of 8.6%. The Defence book-to-sales ratio for the quarter was 0.81 times and for year it was 0.92 times.

And in **Healthcare**, fourth quarter revenue was $33.6 million, down 17% from $40.7 million in Q4 last year. Operating income before specific items was $0.1 million in the quarter compared to $4.2 million in Q4 of last year. For the year, Healthcare revenue was $124.5 million, up from $121.6 million, and segment operating loss before specific items was $3.5 million, representing a decrease of $8.3 million compared to a segment operating income of $4.8 million last year. The lower operating income was mainly because of the negative impacts of COVID-19, which took us off our double-digit topline growth track.

Also, we recorded an impairment charge of $37.5 million relating to goodwill, after considering the general economic conditions and specifically, the deterioration in the global economic environment from the uncertainties of the COVID-19 pandemic as part of our annual goodwill reviews.

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

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

Thanks, Sonya;

The COVID-19 pandemic is a crisis of obviously unprecedented speed and magnitude with respect to the disruption it has caused to our daily lives. The global air transportation environment and air passenger travel have been hit especially hard with a vast proportion of the global commercial and business jet fleets grounded, and, according to IATA's latest forecast, commercial passenger traffic is expected to be down nearly 50% this year. And compounding this already dramatic situation, is the material disruption to CAE operations that we continue to experience.

We face this pandemic; however, from a position of strength, with a global leading market position, a balanced business with recurring revenue streams, and a solid financial position. We've taken decisive yet flexible actions to help to protect our people and operations and to give us the necessary agility to resume long-term growth when the pandemic is behind us. We realize that it may take some time before things get back to normal. In the meanwhile, we're managing the things we can control and we're continuing to identify opportunities for cost savings that we expect to endure long after COVID-19 has passed. In keeping with the notion of hoping for the best and planning for the worst, we're confident in the precautionary measures we're taking, and that we have the liquidity to weather the storm.

The global leadership team and I monitor the daily evolution of the pandemic to evaluate the measures being put in place by local and national governments and the resulting impacts on the company, and to implement necessary contingency plans in real-time as the situation unfolds. So far, the processes that we've put in place to manage through the pandemic are running smoothly and they're effective. We remain focused on protecting employees' health and safety; supporting our customers' critical operations; and ensuring business continuity.

At the same time, the management team and I are looking toward the future and we're already envisioning what the post-COVID-19 era will be like. More specifically, we're imagining how it will be different and what kind of expanded role CAE is likely to play. There's still much uncertainty with respect to the duration and severity of the market downturn but we do know that global air travel will eventually return, and that training will continue to be essential. We don't expect a quick market rebound, but we don't need to see a complete market recovery to be highly successful in the period following the pandemic. The ability to continue to find growth in that context will define great companies and I have every confidence that CAE, the global leader in training, is such a great company.

We're continuing to invest in innovation to enhance our customers' experience, and as the industry thought-leader, we're leading the way to modernize the very fundamentals of training in Civil, Defence and Healthcare. For this reason, I've recently appointed a new member to our executive team, Heidi Wood, as CAE's Executive Vice President, Business Development & Growth Initiatives. I created this role specifically to put focus on partnering with our business unit leaders to identify and drive new avenues of growth across the company, maximize synergies across businesses, and drive our entry into adjacencies and leverage A.I. and Digital technology.

The long-term outlook for the Company remains compelling, with increased potential for long-term partnerships and outsourcings, and the resumption of above-market rates of growth. In the short-term; however, we expect the pandemic to have a significantly negative impact on our performance.

As we look to the year ahead, we believe it will be a tale of two halves, with the first-half of the year defined by sharply lower demand and major disruptions to our operations. For the second-half of the year, we expect performance to potentially be more positive as markets begin to reopen and travel restrictions ease. For the year overall, we expect a material decrease in operational and financial performance, and given the lack of specific visibility, we’re going to refrain from providing our customary growth guidance for the fiscal year.

Looking specifically at **Civil**, currently, 8 of our over 60 civil aviation training locations have suspended operations, and 17 are operating at significantly reduced capacity. These statistics change on a near-daily basis, as local restrictions continue to evolve. The Montreal manufacturing plant, which suspended manufacturing operations for Civil simulator products on March 25th, is now gradually ramping up operations. In terms of backlog, so far, we have only received one full-flight simulator order cancellation from a small, third-party training company, and we’ve received several requests from airlines for deferrals. Demand for new Civil full-flight simulators is closely linked to new aircraft deliveries, which according to the aircraft OEMs, are expected to be down significantly. While the total market will undoubtedly be much smaller this fiscal year, we expect to maintain our leading share of the available simulator sales.

When air travel eventually resumes, we expect to continue building on our previously positive momentum in training, increasing market share and securing new customer partnerships with our innovative training solutions. In the meanwhile, it’s important to distinguish that Civil aviation training is highly regulated, and for pilots to remain active, they must train at a minimum frequency of every six to nine months just to keep their certifications. While airlines globally have suspended the operation of the majority of the commercial fleet, this does not imply a proportionate impact on training demand.

Dispensations have been given in major jurisdictions, including Europe and North America, to extend the deadline of various time-bound training obligations to compensate for travel restrictions and border closures; however, these training requirements will ultimately need to be fulfilled for pilots to retain their licences and resume flight duty. And looking beyond, we’re confident that CAE will increasingly be part of the solution going forward, and that more airline training partnerships and outsourcing opportunities could materialize as the industry looks for ways to gain greater agility and resiliency in the post-COVID-19 era.

In business aviation, while growth-driven training demand is also being negatively affected, our business is largely based on servicing the regulated training needs of the already active global business aircraft fleet and the delivery of large-cabin business jets.

In **Defence**, we benefit from a large backlog of contracts with government customers to provide training solutions and operational support services that are considered essential to national security. To that extent, our training and support services, and manufacturing operations should continue to be relatively unaffected by COVID-19-related restrictions.

Our Defence business has been under new leadership since February, when we appointed Todd Probert as its group president, and has been in the process of bolstering operational efficiencies and effectiveness and expanding its addressable market. In the short-term, COVID-19-related issues are expected to continue to complicate our efforts toward reaching program milestones on product programs in backlog, including for some of our most complex contracts. The COVID-19 impact on order flow should ultimately abate as restrictions are eased; however, the additional realities of a low oil price environment will likely cause expected contract awards in the Middle East to continue to move to the right. That said, we continue to see good bidding opportunities overall with over $3.6 billion of current bids and proposals submitted and pending decisions by customers.

Beyond the current year, the long-term outlook for Defence continues to be for growth, supported by a large addressable market for our innovative training and mission support solutions and the realization of the benefits of our new leadership and bolstered organization.

And finally, in **Healthcare**, we think the business looks well positioned to experience a change in the appreciation of the importance, relevancy and benefits of healthcare simulation and training to help save lives at a steady state and in a healthcare crisis. With its innovative products and demonstrated agility, we are confident Healthcare will become a more material part of the company over the long term.

In summary, we're going through a very challenging period in CAE's history, and our performance will reflect that reality in the current fiscal year. We've taken the most appropriate measures to protect the interests of the Company, employees and all other stakeholders. The fundamentals of CAE remain solid with our global leadership position, high degree of recurring business in regulated markets, and balanced business across markets and geographies. CAE is a highly innovative company with over seven decades of industry firsts under its belt. And at the same time as we manage through this pandemic, we're focused on the future, and I expect we will ultimately be stronger for it.

Before we conclude, I'd like to welcome General David Perkins to the CAE Board of Directors. General Perkins served in the US Army for over 40 years and commanded at all levels to include Major Army Command at the four-star level. His career culminated as the Commander of the United States Army Training and Doctrine Command where he led the Army's concept of Multi-Domain Operations which has become a driver for future changes in operations and training. We're very fortunate to have someone of General Perkins' profile on the CAE Board and we look forward to his strategic counsel as we navigate the way forward.

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

<u>Andrew Arnovitz, Vice President, Investor Relations and Strategy</u>

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

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