CAE

REMARKS FOR CAE'S FOURTH QUARTER AND FULL FISCAL YEAR 2018

May 25, 2018

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 FY19 and answers to questions, contain forward-looking statements. These forward-looking statements represent our expectations as of today, May 25, 2018, 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. For your added convenience, we have posted a presentation on CAE's website to accompany this discussion of our performance and outlook. It also provides some highlights of the adoption by CAE of the new revenue standard, IFRS 15. You can download this document entitled, "Supplemental Q4 FY2018 Presentation" at www.cae.com/investors.

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. I'll come back at the end of the presentation to comment our outlook for the new fiscal year.

We had strong results in the fourth quarter and the full year, having delivered on our growth outlook in all segments. I'm especially pleased with the increased momentum we've gained with our training strategy, as underscored by a record $3.9 billion order intake for the year, and a record $7.8 billion backlog. We grew earnings per share by 8% over last year and we made good progress on our return targets, with return on capital employed growing to above 12%. All in all, a very good performance.

Looking specifically at **Civil**, we booked $545 million of orders during the quarter, for a 1.2 times book-to-sales ratio, including long-term training services in Europe and the Americas, and the sale of five more full-flight simulators.

For the year, Civil booked a record $2.3 billion in orders, for a 1.44 times book-to-sales ratio, giving it a record backlog of $4 billion, which is 21% higher than last year. This is a good indication of the considerable momentum we've gained just in the last year toward realizing our vision to be the recognized global training partner of choice. Orders for the year included 50 FFS sales and comprehensive, long-term training agreements with airlines including Air Asia, Jazz Aviation, Air Transat and Virgin Atlantic Airways to name a few. As well, in business aviation, Civil won long-term training contracts with customers worldwide, including Elit'Avia and Flexjet. Overall for the year, Civil grew segment operating income by 12% and filled its training centres to 76% utilization.

Turning to **Defence**, during the quarter, we booked orders for $435 million, representing a 1.5 times book-to-sales ratio. Notable wins include a training systems integration contract for a comprehensive NH90 helicopter training solution for the Qatar Emiri Air Force, and an S-70B Seahawk helicopter training system for the Brazilian Navy as part of a U.S. foreign military sale program. Highlighting the recurring nature of our defence business, we were also awarded a contract to extend the provision of King Air 350 simulator services to the Royal Australian Air Force, and the U.S. Navy issued additional orders under the MH-60R/S Tech Refresh and Procurement of Simulators program.

For the year, Defence orders included a contract extension to continue providing aircrew training services to the UK Ministry of Defence at CAE’s Medium Support Helicopter Aircrew Training Facility, and a contract to provide the UAE Air Force with a comprehensive training centre for its remotely piloted aircraft. Both contracts highlight CAE’s continued success to bid and win as a global Training Systems Integrator. Defence orders for the year reached a record $1.4 billion for a 1.3 times book-to-sales ratio, and our Defence backlog reached a healthy $3.9 billion.

And finally, in **Healthcare**, we returned to growth this year and we accomplished a number of strategic objectives to enable higher growth beyond. We further developed sales and distribution and we launched a series of innovative products. CAE Juno, our clinical skills manikin for nursing, was very well received by customers, and we introduced LucinaAR, the world's first augmented reality childbirth simulator. We made good inroads as a thought leader with the release of Anesthesia SimSTAT, a screen-based simulation approved by the American Board of Anesthesiology for maintenance of certification credits, and we formed a new partnership with the American Heart Association for the delivery of lifesaving AHA courses in certain markets. We also leveraged CAE’s expertise in augmented reality with innovative training solutions for medical device OEMs, Medtronic and Abiomed. These examples define CAE as the innovation leader in simulation-based healthcare training and education.

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.

Consolidated **revenue** for the fourth quarter was up 6% to $780.7 million, and quarterly **net income** was $100.1 million, or 37 cents per share, which is up 19% compared to 31 cents in the fourth quarter last year, before specific items.

For the year, consolidated revenue was up 5% to $2.8 billion, and annual net income was $347.0 million, or $1.29 per share. Excluding the impacts of the income tax recovery related to the U.S. tax reform and net gains on strategic transactions involving our Asian joint ventures, net income would have been $297.3 million or $1.11 per share. This compares to net income last year of $278.4 million or $1.03 per share, before specific items. On this basis, annual EPS was up 8%.

We generated $117.3 million of free cash flow in the quarter and $288.9 million for the year, which represents an annual cash conversion rate of 97%, excluding the impacts of the aforementioned items. This is in line with our annual average conversion target of 100%. In fiscal 2018, we generated higher earnings which converted into higher cash provided by continuing operating activities. This was partially offset by an investment in non-cash working capital in support of our growth, and mainly a result of timing on accounts payable and work in progress. Overall, a good year from a cash flow standpoint and we expect to continue our focus on improving non-cash working capital efficiency in the year ahead.

Uses of cash involved funding **capital expenditures** for $57.4 million in the fourth quarter and $173.9 million for the year, mainly for the deployment of new simulators to our global training network in support of customer-led growth opportunities. This figure also includes the acquisition of existing simulators from third parties. In line with the customer-driven, accretive investment opportunities that we see in fiscal 2019, we expect to deploy about $200 million of CAPEX, mainly in support of growing customer training outsourcings. In terms of relative capital intensity, CAE's annual CAPEX has continued to decrease as a ratio of total operating cash flows. Our existing asset base generates a high level of recurring cash flow, and in addition, the simulators we've deployed to our network in support of growth over the last five years have typically ramped up within about 24 months to generate accretive incremental returns and free cash flows.

Other uses of cash included the distribution of $89.9 million in dividends for the year. In addition, we repurchased and cancelled approximately 2.1 million common shares under the NCIB program during the year, for another $44.8 million. In all, between dividends and share buybacks, CAE returned $134.7 million to shareholders during fiscal 2018, which represents a 10% increase over last year.

Looking at capital returns, we saw a significant increase on **return on capital employed** to 12.3% from 11.2% last year. As well, CAE's financial position became even stronger with **net debt** of $649.4 million at the end of March, for a net debt-to-total capital ratio of 21.5%. This is down from $750.7 million or 26.5% of total capital, at the end of last year.

Income taxes were $13.7 million this quarter, for an effective tax rate of 12%. This compares to 17% in the fourth quarter last year. The decrease from last year was mainly due to a change in the mix of income from various jurisdictions, mainly from the recognition of deferred tax assets due to our increased profitability in certain European countries. Excluding the effect of this item, the income tax rate would have been 23% this quarter. For the year, excluding the impact related to the U.S. tax reform, the recognition of the deferred tax assets, and net gains on strategic transactions relating to our Asian JVs, the effective tax rate would have been 21%.

Now turning to our segmented performance.

In Civil, fourth quarter revenue was up 9% year over year to $455.2 million and operating income was up 14% to $95.7 million, for a margin of 21%. For the year, Civil revenue was up 5% to $1.63 billion and operating income, before the net gains on strategic transactions relating to our Asian JVs, was up 12% to $306.2 million for an annual margin of 18.8%.

In **Defence**, fourth quarter revenue of $290.4 million was up 3% over Q4 last year, while operating income was up 17% to $38.7 million, for an operating margin of 13.3%. For the year, Defence revenue was up 5% to $1.09 billion and operating income was up 6% to $127.7 million, representing a margin of 11.8%.

And in **Healthcare**, fourth quarter revenue was $35.1 million, up from $34.2 million in Q4 last year. Healthcare segment operating income was $6.7 million, or 19.1% of revenue, in the quarter compared to $4.1 million, or 12% of revenue, in Q4 of last year. For the year, Healthcare revenue was $115.2 million, up from $110.7 million, and segment operating income was $8.8 million, up from $6.6 million last year.

Before I turn the call back over to Marc, I'll say a few words about the new accounting Standard IFRS 15, relating to *Revenue from Contracts with Customers*, which CAE adopted as of April 1, 2018.

This standard changes the way we recognize revenue for certain customer contracts, impacting mainly the timing of revenue recognized for our Civil simulator products, which are currently accounted for using the percentage-of-completion method. Under the new standard, revenue for these products will instead be recognized upon completion. This change impacts the timing of contract revenue or profit recognition, which may result in some quarterly volatility, but there will be no change to milestone payments and cash flows from contracts.

The impacts of IFRS 15 on our fiscal 2018 results can be found in note 2 of our annual consolidated financial statements and in our 'Supplemental Q4 FY2018 Presentation.' For Fiscal year 2018, the net impact of the new standard was a one cent deferral of EPS.

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

Marc Parent, President and Chief Executive Officer

Thanks, Sonya;

CAE continues to benefit from steady, secular tailwinds in each of our three core markets of civil, defence and healthcare, and we're well positioned for sustainable, profitable growth. The macro environment is highly supportive, and just as encouraging, if not more so, is the momentum we currently have in the market as a credible training partner for our customers. As we look to the year ahead, we expect CAE to exceed the growth rate of our end markets as our large pipeline translates into even more opportunities for market share gains and new customer partnerships.

In **Civil,** the market fundamentals are well supported by continued passenger traffic growth and the expanding global in-service fleet of aircraft. So far in 2018, we've seen continued high rates of commercial passenger traffic growth—especially in high growth regions like Asia Pacific, where CAE is highly active as a training partner. This growth continues to be well in excess of the long-term global average of about 4%.

Pilot training demand is fundamentally driven by regulations governing the flight crews who operate the global in-service fleet, and incrementally, by the large number of new pilots who need to be trained over the next decade. I remain highly encouraged by CAE's prospects in this environment. CAE is a pure-play, training services company that is well defined as an innovation leader, with the largest and broadest global training network, and the most comprehensive offering of cadet-to-captain training solutions. We're harnessing the latest in augmented and virtual reality and the power of Digital, with new data-driven solutions. For example, we commercialized, 'CAE Rise,' in fiscal 2018 to provide our training customers with a powerful new tool capable of objective pilot assessment and providing much deeper training insights than previously thought possible. We currently have an active pipeline of airline outsourcing opportunities, and I believe our well-differentiated position gives us even greater potential for more long-term, recurring training partnerships for CAE.

Commercial aircraft deliveries drive full-flight simulator sales and with major commercial aircraft OEMs still delivering aircraft at high rates, we expect continued good demand for our products and to maintain our leadership position. We sold 50 FFSs again last year, and we're off to a good start in the first couple of months of the new fiscal year, with our first 10 already sold.

In business aviation, we've been doing very well to address the existing market and I'm encouraged by the signs of improvement we continue to see with increasing business jet utilization. CAE is well positioned to provide its customers with an excellent experience and to continue gaining market share.

For **Civil** overall, the year ahead looks bright, and we expect to continue generating low double-digit percentage operating income growth as current momentum for our innovative training solutions translates into market share gains and new customer partnerships in commercial and business aviation training.

In **Defence**, the macro environment is also highly supportive with governments around the world placing a high priority on mission readiness and looking for outsourcing alternatives involving industry partners like CAE, for the creation and maintenance of critical operations personnel. Here too, we're seeing increased momentum as we continue to convert our large bid pipeline into orders. We believe CAE is well positioned to continue growing its share as a Training Systems Integrator inside of a $17 billion market. Current bids and proposals pending customer decisions is currently as high as ever, at over $4.5 billion. Last year, we continued to demonstrate our ability to bid and win as a top-tier, Training Systems Integrator, and we're already off to a solid start in fiscal 2019 with the recent win of a five-year, $150 million contract to support U.S. Navy pilot training. We'll be providing instructors at five Naval Air Stations to support primary, intermediate and advanced pilot training for U.S. Navy, Marine Corps and Coast Guard aviators using a combination of simulators, and the T-6B Texan turboprop and the T-45C Goshawk jet aircraft. This is another strategic win for us, demonstrating the Navy's recognition of CAE as a world-class provider of comprehensive training solutions and services.

We expect the positive momentum in Defence to translate into mid to high single-digit percentage operating income growth in fiscal 2019, as we deliver on contracts in our backlog and continue to win our fair share of orders from a large pipeline.

And finally, in **Healthcare**, we expect to resume double-digit growth this year with the benefits of our broader market reach and expanded products offering. As well, we have a development pipeline of innovative solutions which we will continue to launch during the year to increase CAE's share in relatively large segments like nursing. We maintain a positive view of CAE Healthcare's long-term potential as the use of simulation expands for education and training, and we remain confident that Healthcare will become a more significant part of CAE's overall business.

In summary, CAE has the benefit of an increasingly recurring base of business and significant headroom for long-term, profitable growth inside markets that are themselves, experiencing secular tailwinds. Our strategy in training is working well, and we have the momentum to continue growing at a superior rate to our end markets. We take great confidence in the strength of our position as an innovation leader, and increasingly, the recognition of CAE by customers as the global training partner of choice.

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

Andrew Arnovitz, Vice President, Investor Relations and Strategy

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.