

CORPORATE PARTICIPANTS

Marc Parent
President & Chief Executive Officer

Sonya Branco
Chief Financial Officer

Andrew Arnovitz
Vice President, Strategy & Investor Relations

CONFERENCE CALL PARTICIPANTS

Cameron Doerksen
National Bank Financial

Chris Murray
AltaCorp Capital

Jean-François Lavoie
Desjardins Capital Markets

QUESTION AND ANSWER SESSION

Operator

Our first question comes from the line of Cameron Doerksen with National Bank Financial. Please proceed.

Cameron Doerksen, National Bank Financial

Thanks and good afternoon. I guess my first question is just on the R&D program that you announced recently. I mean CAE has always spent a lot of money on innovation in R&D, but this maybe feels a bit like an acceleration of the spend and I'm just wondering if there's going to be sort of noticeable impact on, I guess, the cash flow or margins as a result of that.

Sonya Branco, Chief Financial Officer

Hi, Cameron. It's Sonya. So, great announcement I think, great for continued investment in CAE and in Canada and Quebec. Now, well, this is really a focus of our R&D resources and skill set to more digital technology and innovation. In terms of level of R&D, it will not necessarily have a significant impact on our run rates and pretty much incorporated into our outlook. In terms of cash flow, this will not have an impact on the run rate.

Cameron Doerksen, National Bank Financial

Okay. Very good. And maybe just quickly a question about the AOCE business that you just recently purchased. I'm wondering if you could just talk a bit about the margin profile of that business, because does look like it's, I guess, predominantly a services business.

Sonya Branco, Chief Financial Officer

So, this is a great bolt-on acquisition and it's a great strategic bid and it brings along a backlog of a contract that broaden the spectrum of defense platforms like fighter aircraft and higher security contracts. The general run rate is about \$100 million plus of revenue. It is a pure-play services entity and therefore margins reflect that. It's expected to be accretive in its full year of operations. For the year, it will be slightly accretive, but we will be taking into account some integration costs and cost that synergize into our own operations. For the year it will be just slightly accretive.

Cameron Doerksen, National Bank Financial

Okay. Thanks very much.

Operator

Our next question comes from the line of Chris Murray with AltaCorp Capital. Please proceed.

Chris Murray, AltaCorp Capital

Thanks. Good morning or good afternoon. Just looking at defense margins, they were a little bit lighter than I think we would have expected, and I think you know part of that was maybe some of the higher R&D expenses. Can you just maybe walk through kind of the moving parts on margins in defense and how we should think about mix as we move through the year?

Marc Parent, President & Chief Executive Officer

Maybe I'll start it off. It's Marc. I think what you're seeing here, I mean part of the answer is what you just mentioned, is higher R&D spend in the quarter. The bulk of it is, you know, we've said in the past and I think we've come to, we've hit it the spades in the quarter, but this business is better looked at on 12-month basis, because in an individual quarter you can have you know programs being executed, or in this case just, you know, we missed

some milestones for a completion of a couple of programs, and that makes the big difference in terms of how much revenue and income you can basically generate in the quarter. I mean you'll recuperate that, because the program is not lost, it's just booked in a different quarter, and that's what happening here, the lumpiness in the quarter. That's the bulk of it. And you throw on top of that the lack of the revenue and income on those programs coupled with a higher level of R&D spend and you kind of get the result. But when we look at the year as a whole, we're not concerned about the outlook that we've given, it's really the mix that we had in the quarter of programs that we executed.

I don't know if you want to add anything on that, Sonya?

Sonya Branco, Chief Financial Officer

Really it was the mix added with the timing on certain R&D expenses, which were a little bit higher this quarter. But overall, if we take the backlog as a whole, we continue to see 12%. But it will vary as it flows through income. So we continue to see essentially our outlook, which is mid to high single digits. It will, given some timing and some services from the work stoppage, be more backhanded in the second half.

Chris Murray, AltaCorp Capital

And that was my next question. Sorry, go ahead, Marc.

Marc Parent, President & Chief Executive Officer

I was just going to talk about... Specifically when we talk about mix on the defense, we're really talking about, at least I was talking about, the mix between products and services, because the ones that are more lumpy are the products one. And they tend to be typically higher margin little margin as well. So that also explains the result in the quarter on defense specifically.

Chris Murray, AltaCorp Capital

Okay. And I guess that brings me to my next question. Just how should we think about shifts around the strike and the impact of the strike? It kind of feels like, you know, you talked about working capital a little bit being impacted. Should we think about that there if there was perhaps some revenue that's getting shifted either into Q2 or into further quarters? Is that the right way to think about it? And is there any sort of lost revenue or lost

earnings or is this just going to be, as you said, more timing issues in the quarter?

Marc Parent, President & Chief Executive Officer

Well, the bulk of it is going to be shifting into the second half, as we said in our outlook. If you think about it, for a couple of reasons, as Sonya was saying on the call, if you think about, you know, we were stopped for the better part of five weeks, so we shipped a couple of products out the door during that time nevertheless. So we have accelerated or we have a recovery plan underway that's making up for that time, work over Christmas, for example, we'll have more shifts on, those kind of activities, to recover. So when we look at the year as a whole, we think we have high confidence that we can recuperate the revenue and profits that we've lost.

But if you look at, you know, now with IFRS 15, specifically on civil, the simulators for example, we will only be able to recognize revenue and profit at delivery now. So, rather than in the past where we were on a percentage of completion, which is what are defense contracts largely are on, which means that if we were stopped and no simulators, you know, our recovery plan now, are going to be delivered probably more in the back half in Q3 and Q4 rather in Q2, Q3, and that's really the bulk of what you're going to see.

Sonya, I don't know if you want to add a bit more colour to that?

Sonya Branco, Chief Financial Officer

Yeah, so whatever revenue and profit that we would have generated in those five weeks is delayed and essentially shifted to the back half. And that's in addition to the already, ah, delivery completion which was already back half due to the new revenue recognition.

Chris Murray, AltaCorp Capital

All right. That helps. Thank you very much.

Marc Parent, President & Chief Executive Officer

I don't know if I answered it specifically but I don't think, I mean going specifically, I don't think we see any revenue and profit that is lost as a result of this.

Sonya Branco, Chief Financial Officer

No.

Chris Murray, AltaCorp Capital

Thank you.

Operator

Our next question comes from the line of a Jean Francois Lavoie with Desjardins Capital Markets. Please proceed.

Jean-François Lavoie, Desjardins Capital Markets

Thank you very much. I was wondering if you could provide us with a little bit more details about your expectation for the healthcare business in terms of revenue toward the back end of the year please.

Marc Parent, President & Chief Executive Officer

Well, I think, as we said in our remarks, we're still feeling very confident that we will achieve the outlook that we have for this year, which is double-digit growth, both in top and bottom line. And as I look at order profile this quarter, I mean this is not a backlog run business. I mean it relies on our visibility that we have with customers on their expected buying behavior this year and based on what we see, and I can tell you it's a pretty detailed analysis, we feel pretty good about, very good actually, that will achieve that outlook that we have.

We've invested even more in this business, in terms of R&D. We've launched a new product in the market just recently, last two weeks CAE Ares, in the mid-fidelity market and so far the receptivity of our products in that market has been very good, and that's what we see. That is where the bulk of this, the revenue, is being spent in this business is in the mid-fidelity market. So, again, we're feeling very good about the outlook that we have.

Jean-François Lavoie, Desjardins Capital Markets

Great. Thank you very much. And maybe last one for me. You had a very strong first quarter in terms of full-flight order, full-flight simulator order, so I was wondering what is your outlook or your expectation for the second half in terms of order.

Marc Parent, President & Chief Executive Officer

Well, if you look at where we're at, as you said, we're at 26 simulators half way through the second quarter, so I think it suffices to say we'll have a good year. It's a bit early for me to get outside what we've said already. I think we said in the 40s, I think, and I think that's where we expect to be at the moment.

Jean-François Lavoie, Desjardins Capital Markets

Okay, perfect. Thank you very much.

Marc Parent, President & Chief Executive Officer

It's a strong market and we have strong... The market it continues to be strong on the simulator sales in terms of the opportunities that we're bidding on. So we feel good about the outlook.

Jean-François Lavoie, Desjardins Capital Markets

Great. Thank you very much.

Operator

Ladies and gentlemen, we will now proceed with questions from the press and media. If you would like to register a question, please press the one followed by the four on your telephone.

Mr. Parent, here are no further questions at this time.

Andrew Arnovitz, Vice President, Strategy & Investor Relations

Thank you very much, operator. I want to thank all participants for joining us on the call today and to remind you a transcript of the call will be available on CAE's website.

Operator

Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your line. Have a great day, everyone.
