



REMARKS FOR CAE'S FIRST QUARTER FISCAL YEAR 2019

August 14, 2018

Time: 1:30 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, August 14, 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.

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 then Sonya will review the detailed financials. I'll come back at the end to talk about our outlook.

CAE's performance in the first quarter was led by Civil, which had double-digit growth and saw strong customer demand for our innovative training solutions. Defence and Healthcare are more variable on a quarterly basis, and the first quarter reflects this tendency. Overall, we had solid order intake at \$689 million, giving us a total CAE backlog of \$8 billion at the end of the quarter. We grew revenue by 10% year on year, and EPS of \$0.26, was up 18% over Q1 last year. Our overall performance in the quarter supports our outlook, which was further reinforced by some of the positive developments since the end of the quarter.

Looking specifically at **Civil**, we booked \$499.3 million of orders in Q1, plus additional contracts involving joint ventures, including an exclusive long-term pilot training agreement with Asiana Airlines. We also announced a new joint venture and training outsourcing for Avianca Airlines in Colombia, and an exclusive training agreement with Volaris of Mexico. In business aviation, Civil signed an exclusive long-term pilot training contract with OJets, and in products, we sold 18 full-flight simulators to customers across all regions. Training centre utilization during the quarter was 80%.

Turning to **Defence**, during the quarter, we booked orders for \$166.9 million, including a contract from the U.S. Navy to provide instruction at five Naval Air Stations to support primary, intermediate and advanced pilot training. We also signed contracts involving training for the Brunei Ministry of Defence's S-70i Black Hawk simulator, upgrades on German Air Force Tornado simulators, and support solutions for the Royal Canadian Air Force's CF-18 aircraft.

And finally, in **Healthcare**, we launched the CAE Ares emergency care manikin during the quarter, which is designed to meet the life support training requirements of emergency care providers worldwide.

As well, Healthcare, together with the American Society of Anesthesiologists launched the Anesthesia SimSTAT - Appendectomy module, the latest in a series of interactive screen-based courses approved for Maintenance of Certification credits.

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?

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

Thank you, Marc, and good afternoon everyone.

Consolidated **revenue** for the first quarter was \$722.0 million, and quarterly **net income** was \$69.4 million, or 26 cents per share. This compares to 22 cents in the first quarter last year.

Income taxes this quarter were \$10.9 million, representing an effective tax rate of 13%, compared to 16% for the first quarter last year. Excluding the effect of tax audits in Canada, the income tax rate would have been 19% this quarter.

Free cash flow was typical of CAE's start of the fiscal year, in the sense that we usually see a higher level of investment in non-cash working capital during the first half. The investment this quarter was higher than in Q1 last year, and I would note the five-week manufacturing work stoppage in Canada that began in June, caused some delays reaching billing and cash collection milestones. As such, first quarter free cash flow from continuing operations was negative \$85.8 million compared to negative \$37.9 million last year. As in previous years, we expect a portion of the non-cash working capital investment to reverse in the second half.

Uses of cash in Q1 included funding **capital expenditures** for \$53.1 million, mainly for growth, and we distributed \$23.1 million in cash **dividends**. We used another \$6.5 million to buy back stock under the **NCIB** program.

Now looking at our segmented performance...

In Civil, first quarter revenue was up 16% year over year to \$430.9 million and operating income was up 14% to \$78.3 million, for a margin of 18.2%. On the order front, the Civil book-to-sales ratio for the quarter was 1.16x and for the trailing 12-month period is was 1.45x. Civil's backlog at the end of the quarter was \$4.1 billion.

In **Defence**, first quarter revenue of \$268.3 million was up 3% over Q1 last year, while operating income was down 10% to \$21.5 million, for an operating margin of 8.0%.

The timing of milestones and product/service mix often causes quarterly variability in Defence, and in the first quarter, we incurred a relatively higher level of R&D expenses on active programs. The Defence book-to-sales ratio was 0.62x for the quarter and 1.20x for the last 12 months. Defence backlog at the end of the quarter was \$3.9 billion.

And in **Healthcare**, first quarter revenue was \$22.8 million, down from \$23.9 million in Q1 last year. Healthcare segment operating loss was \$1.3 million in the quarter compared to a loss of \$1.6 million in Q1 of last year.

Before I turn the call back over to Marc, I'll say a few words about our expected revenue and profit profile this fiscal year, which is more heavily weighted to the second half. The new accounting Standard IFRS 15, which CAE adopted as of April 1, 2018, changed the way we recognize revenue for certain customer contracts, impacting mainly the timing of revenue recognized for our Civil simulator products. Under the new standard, revenue for these products is recognized upon completion and we expect more of our simulator product deliveries to take place in the second half of the year. This is especially so in light of our efforts now to mitigate the impact of the five-week work interruption that began in June. We are pleased to have maintained CAE's competitiveness with the successful negotiation of a new collective agreement—of four years plus a one year option—with CAE's manufacturing employees in Canada, and we are maintaining our growth outlook for the year.

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

Marc Parent, President and Chief Executive Officer

Thanks, Sonya;

Our outlook continues to be positive and we're well positioned for sustainable and profitable growth over the long term. In keeping with our capital allocation priorities, and echoing our positive long-term outlook, CAE's Board of Directors, this morning, approved a one cent or 11% increase to CAE's quarterly dividend, which becomes 10 cents per share, effective September 28, 2018.

Over the last several quarters, we've made reference to our increased momentum as a credible training partner for our customers. We've recently made significant inroads with our training strategy as evidenced by several new and expanded customer outsourcing agreements. And we continue to see a large pipeline of training opportunities to increase our share of the market and to form new enduring customer partnerships.

In **Civil**, our customers value the fact that we're a pure-play training company and they recognize CAE as an innovation leader, with the largest and broadest global training network, and the most comprehensive offering of cadet-to-captain training solutions. As testimony to our momentum, in recent months we've signed a series of important long-term airline training partnerships, which taken together, speak to CAE's credibility and market reach. To recap our progress, these include our joint venture with Singapore Airlines, which is now operational, and our new joint venture in Colombia with Avianca Airlines, which further strengthens our position in Latin America. We signed long-term exclusive training agreements with Jetstar Japan and Asiana Airlines, both of which selected CAE as an innovation leader, offering capabilities like the CAE Rise™ training system. These wins serve to give CAE increased recurring revenue and cash flows and the opportunity to make accretive growth investments right in our core market of training. Our pipeline of airline outsourcing opportunities remains highly active, and I believe our well-differentiated position, and recent successes give us even greater potential for more long-term, recurring training partnerships for CAE.

We continue to have solid momentum in business aviation as well and we are well positioned to provide customers with an excellent experience and to continue gaining market share.

And in simulator sales, we're off to a strong start with 26 full-flight simulator sales already signed, halfway through the second quarter. We expect to continue to lead the simulator products market this year and for Civil overall, our outlook for low double-digit percentage operating income growth this year remains unchanged.

In **Defence**, we're also making good progress with our Training Systems Integration strategy and I'm especially pleased with the acquisition of Alpha-Omega Change Engineering (AOCE), announced earlier this month, which expands our position in the US defence market. Much like our acquisition a few years ago of the NATO Flying in Canada, or NFTC, program, this acquisition enhances our core capabilities as a training systems integrator and grows our position on enduring platforms such as fighter aircraft. Last quarter, I mentioned that we had just established a new proxy structure to be able to pursue higher-level security programs in the United States. As an extension of this initiative, the pure-play services business, AOCE we just acquired fits under our new proxy structure, and will help us to open up a nearly \$3 billion larger addressable market. CAE's global addressable market in defence now stands at about \$17 billion, so we're feeling confident about CAE's potential to grow inside this large market. Another important measure is the level of our current bids and proposals pending customer decisions, which is currently over \$4.5 billion. Governments around the world are placing a high priority on mission readiness and we continue to be successful converting bids into orders to serve our customers' needs. Just last week, we announced a new contract of over \$50 million, including options, to provide the Royal New Zealand Air Force with CAE's latest 700MR Series simulator and related support services for NH90 helicopter training.

We continue to expect Defence to generate 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 now expanded pipeline.

And finally, in **Healthcare**, our new products are being well received by the market and we continue to expect double-digit growth this year with the benefits of our broader market reach and expanded products offering.

One of CAE's main areas of **strategic priority** is *innovation*, and our latest horizon of innovation is focused on Digital technology. CAE is a market leader in aviation training with a 70-year track record of industry firsts. We're now developing Digital-enabled solutions to transform the way aviation training is done. These solutions enable us to deliver the best possible customer experiences, and to grow our share in large and growing markets with even greater differentiation as the worldwide training partner of choice. Our latest digital innovation, CAE Rise, is a revolutionary new training system that enables the objective assessment of pilot competencies using live data during training sessions. The system harnesses the power of cloud-based computing and analytics to provide CAE with deep insights that bring our customers' aviation training experience to new levels.

Last week we announced, in partnership with the Government of Canada and the Government of Québec, "Project Digital Intelligence," which is a digital innovation project to develop our next generation training solutions. By seizing new technologies such as artificial intelligence, big data, and augmented reality, and applying them to the science of learning, CAE will continue to revolutionize our customers' training experiences.

It's a great time to be CAE, and I'm highly encouraged by the progress we continue to make with our training strategy. We have a high degree of credibility with our customers and good momentum winning new partnerships and training outsourcings. In addition to sustainable and profitable financial performance, investors expect companies like ours to model social responsibility and to benefit society. I'm proud to say we are such a company, and we believe CAE's noble purpose and profits go hand-in-hand. As an example of our leadership, at the recent Farnborough Airshow, we introduced the CAE Women in Flight scholarship program, demonstrating our commitment to promoting the advancement of women in the aviation industry. Women currently represent less than 5% of civil aviation pilots and instructors, and given the industry challenges, it makes perfect sense to be tapping into the wider talent pool. CAE's program encourages passionate and exceptional women to accomplish their goal of becoming professional pilots. I would encourage you to have a look at CAE's new Annual Activity and Corporate Social Responsibility report, which is available on our website.

Before we open the line to questions, I want to express my sincere gratitude to Jim Hankinson, who retires today from CAE's Board of Directors and steps down as its Chairman. Jim served as Chairman for the past 5 years and as a Director for 23 years. He leaves CAE a financially strong company with rigorous governance processes; and he provided invaluable strategic counsel as CAE transformed into the aviation training leader it is today. Also departing the CAE Board is retired US Army General Peter J. Schoomaker, who reached the mandatory term limit for a CAE Director. General Schoomaker first served as a Director on the CAE USA Board and then on CAE's Board for the past nine years. We benefited greatly from his insights, which helped to shape CAE's defence strategy and to position the Company in the US defence market, in particular. We thank you, General, for your excellent counsel!

Turning from retirements to appointments, I'm very pleased to add my welcome to CAE's new Chairman, the Honourable John Manley, who has been a CAE Director for the last 10 years and brings extensive company knowledge and continuity to the fore, and we have every confidence that CAE will continue to thrive under his strong leadership. John also serves as President and Chief Executive Officer of the Business Council of Canada and is a former Deputy Prime Minister of Canada.

Also named to the CAE Board today is retired United States Air Force General, Norton A. Schwartz, who was previously a Director on the CAE USA Board. General Schwartz is currently President and CEO of Business Executives for U.S. National Security, and he served as the 19th Chief of Staff of the US Air Force. He was responsible for the organization, training and equipping of nearly 700,000 service members and was an adviser to the Secretary of Defense, National Security Council and the President. His deep industry knowledge and extensive experience, especially in the area of defence aviation training, make him a truly great addition to the CAE Board.

And finally, filling the vacancy created by General Schwartz on the CAE USA Board, I want to welcome, General Frank Gorenc—a highly decorated retired General in the United States Air Force who rose to the highest levels of leadership in the United States Military as one of twelve Air Force Four-star Generals. He also reached the highest levels of NATO as one of six commanders within the NATO Command Structure.

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.