CAE

REMARKS FOR CAE'S THIRD QUARTER FISCAL YEAR 2023

February 14, 2023

Time: 2:00 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 14, 2023, 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'll open the call to questions from financial analysts. At the conclusion of that segment, we'll open the lines to 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.

We had strong results in the third quarter, driven by Civil's double-digit growth, Defense's sequential improvement, and Healthcare's increased profitability. We also ensured our path to future growth by securing over $1.2 billion in total adjusted order intake for a record $10.8 billion adjusted backlog and 1.22 times book-to-sales ratio.

In Civil, we booked $713 million of orders from a large opportunities pipeline, resulting in a 1.38 times book-to-sales ratio. This is an especially noteworthy accomplishment, considering this is on revenue that's 33 percent higher than last year. Orders include long-term commercial aviation training agreements with GOL Airlines and MESA Airlines, and a multi-year business aviation training agreement with Delux Public Charter. We also made excellent progress with our flight operations software solutions, with notable agreements including a five-year contract with Ethiopian Airlines for our next-gen crew and operations manager solution suite, and since the end of the quarter, an agreement with Frontier Airlines for our next-gen operations solutions. Demand for full-flight simulators continued to be strong with 14 sales in the quarter, bringing our year-to-date total to 43.

Civil's financial and operational performance was also strong in the third quarter, with double-digit growth and near-record margins. We delivered nine full-flight simulators in the quarter, and average training centre utilization was 73%, up from 60% last year. Commercial aviation training demand continued to be strongest in the Americas, followed by a seasonal uptick in Europe and then Asia, which has improved with the ongoing easing of travel restrictions in China. In business aviation, training demand continued to be robust throughout our network, reflecting a high level of pilot training to support business aircraft flight activity, which continues to exceed pre-pandemic levels.

In **Defense**, the leading indicator of our progress toward a larger and more profitable business is order intake. This quarter, we booked orders across domains for training and mission support solutions valued at $477 million for a 1.05 times book-to-sales ratio. This marks the sixth consecutive quarter this ratio has been above one, and situates us with a book-to-sales ratio of 1.25 times on a trailing twelve-month basis.

Notable orders in the air domain include the provision of a flight training device and maintenance and logistics support for the Royal Canadian Air Force's CH-149 Cormorant search-and-rescue helicopter, the continuation of aircrew training on the KC-135 Stratotanker and C-130H Hercules for the United States Air Force, and international flight training device upgrades for the F-16 fighter jet and CH-53G heavy-lift transport helicopter.

In the land domain, we were awarded funding for our Joint Terminal Control Training Rehearsal System solution, which builds on the success of our previous funding award for a new virtual training capability for soldiers to the US Army on the Soldier Virtual Trainer prototype contract. We also booked orders in the space and cyber domains, highlighted by the proliferation of CAE's solutions for distributed, networked and cybersecure mission training via the US Air Force's SCARS program. And since the end of the quarter, we booked orders in the sea domain with our ongoing work with Lockheed Martin on the Canadian Surface Combatant ship program.

Defense also continued to build on its foundation of U.S. Army support with the successful competitive re-compete for Fixed-Wing Flight Training Service, which involves the provision of comprehensive initial and recurrent training for more than 600 U.S. Army and U.S. Air Force fixed-wing pilots annually at the CAE Dothan Training Center in Alabama. The approximate total value of the base contract and options is US$250 million, with a period of performance through 2032. This was awarded to us with an effective date commencing in our fourth quarter and accordingly, will be reflected in our next quarter order intake. Also involving U.S. Army aviation, our prime partner on the U.S. Army's Future Vertical Lift, Bell Helicopter, was awarded the FLRAA program, which will field the V-280 Valor tiltrotor to eventually replace the long-serving UH-60 Black Hawk. Pending protest resolution on this award, CAE will support Team Valor by delivering a range of training devices, solutions, and courseware for Bell's family of systems.

We've continued to place a strong focus on our operations and asset optimization in the face of the ongoing macroeconomic challenges impacting the defence industry as well as the broader economy. As a result of these efforts, our financial performance for Defense in the quarter improved sequentially, and was largely in line with what we expected.

With that, I'll now turn the call over to Sonya who will provide additional details about our financial performance. Sonya?

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

Thank you, Marc, and good afternoon, everyone.

Consolidated revenue of $1,020.3 million was 20% higher compared to the third quarter last year. **Adjusted segment operating income** was $160.6 million, compared to $112.7 million in the third quarter last year. Quarterly **adjusted EPS** was 28 cents, compared to 19 cents in the third quarter last year. Adjusted EPS this quarter includes an approximate $0.02 positive impact as a result of gains on the reversal of impairment of non-financial assets following their repurposing and optimization. We incurred restructuring, integration and acquisition costs of $4.9 million during the quarter, relating mostly to the AirCentre acquisition, and this also includes a $9.8 million impairment reversal.

Net cash provided by operating activities this quarter was $252.4 million, compared to $138.0 million in the preceding quarter and $309.6 million in the third quarter of fiscal 2022. **Free cash flow** was $237.7 million compared to $108.4 million in the preceding quarter and $282.1 million in the third quarter last year. The sequential increase was mainly due to a lower investment in non-cash working capital and higher cash provided by operating activities, while the decrease compared to the third quarter last year was mainly due to a higher investment in non-cash working capital, which was partially offset by higher cash provided by operating activities.

Capital expenditures totaled $63.4 million this quarter, with approximately 75 percent invested in growth, to specifically add capacity to our Civil global training network to deliver on the long-term training contracts in our backlog.

Income tax expense this quarter was $17.1 million, for an effective tax rate of 18%. 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 19%.

Our **Net debt** position at the end of the quarter was approximately $3.1 billion, for a net debt-to-adjusted EBITDA of 3.74 times at the end of the quarter. This 43-basis-point improvement from last quarter puts us solidly on track to meet our targeted leverage ratio of below 3 times net debt-to-adjusted EBITDA by the middle of next fiscal year.

Net finance expense this quarter amounted to $48.8 million, which is up from $41.3 million in the preceding quarter and $34.5 million in the third quarter last year. Approximately 70 percent of our debt obligations are fixed rate, and the increased finance expense largely reflects the impact of higher interest rates on our variable rate debt instruments. For now, we’re assuming a go-forward quarterly run rate for this expense in the range of the current quarter.

Now turning to our segmented performance...

In Civil, third quarter revenue was up 33% to $517.4 million, compared to the third quarter last year, and adjusted segment operating income was up 58% to $131.4 million vs. the third quarter last year, for a margin of 25.4%. Our strong year-over-year Civil performance was mainly due to higher training network utilization and the integration of AirCentre into our results, which represented approximately 10% of Civil revenue in the quarter.

In **Defense**, third quarter revenue of $452.5 million was up 6% over Q3 last year. Adjusted segment operating income was $25.4 million for the quarter, down from $32.0 million in the third quarter last year. The revenue growth stems from FX translation and a higher level of activity on programs, while the lower adjusted segment operating income reflects higher costs associated with inflation, supply chain disruptions and labour shortages. This was partially mitigated by a reversal of impairment on an intangible asset following their repurposing and optimization and cost reduction initiatives.

And in **Healthcare**, third quarter revenue was $50.4 million, up from $32.1 million in Q3 last year, mainly due to increased sales of patient simulators and centre management solutions. Adjusted segment operating income was $3.8 million in the quarter, for an adjusted segment operating income margin of 7.5% compared to a loss of $2.7 million in Q3 of last year.

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

Marc Parent, President and Chief Executive Officer

Thanks, Sonya.

The strength we saw in the third quarter gives us additional confidence in both our fiscal year 2023 outlook as well as our long-term targets.

We're excited about **Civil's** prospects as we build on our industry-leading position with the most innovative training and critical operations support solutions, and we expect to see significant growth during and beyond the ongoing global aviation market recovery. We anticipate continued strong growth in commercial aviation training as flight capacity rises to meet travel demand, and as mobility restrictions abate in China, which remains a key driver for airlines mainly operating in Asia Pacific but also worldwide.

In business aviation, flight activity has remained above pre-pandemic levels and we continue to see strong demand for business aviation pilot training. We have been and will continue to deploy training capacity in lockstep with demand in this segment of the market.

We continue to expect Civil performance to be strongest in the fourth quarter, with a mix involving about twice as many full-flight simulator deliveries as in the third quarter, which gets us to our estimate of 45-plus for the fiscal year. We also have more simulators coming online in our global training network which makes for a larger base of revenue. We've done very well with full-flight simulator sales year-to-date, and we expect to maintain that momentum, winning our fair share.

In **Defense**, despite the macroeconomic headwinds, order delays, and potential U.S. budget complexities, which are expected to extend into the next fiscal year, our continued sequential growth, along with positively trending bookings and backlog renewals, adds to our confidence in our multi-year view. Defence represents a secular growth market for CAE, and we believe the sector is in the early stages of an extended up-cycle, driven by geopolitical realities and increased commitments to defence modernization and readiness.

We're now sustaining higher order intake, replenishing and renewing our backlog with new and more profitable defence contracts. We expect this trend to continue and for Defense to strengthen over a multi-year period to a low double-digit percentage adjusted segment operating income margin profile. We're bidding more and we're bidding larger, with a pipeline of multiple $100 million-plus programs, and a number of $1 billion-plus programs that we're bidding over the next three years.

We're highly focused on execution, and as we look to the remainder of the current fiscal year, we expect further sequential improvement for Defense in the fourth quarter.

And in **Healthcare**, we are on a path to accelerate value creation by gaining share in the simulation and training market, and driving top- and bottom-line growth. We have a strong team and I expect to see their positive momentum to continue.

Our **capital allocation priorities** are unchanged, with a focus on organic investments that are made in lockstep with customer demand. We're on track to meeting our leverage target by the middle of next fiscal year, which at that time, will further increase our financial flexibility. The CAE management and Board of Directors are also prioritizing returning capital to shareholders in a timely manner, which is a key aspect of our capital allocation strategy.

In summary, the strength of our performance in the quarter and our current expectations for the balance of the year allow us to reiterate our outlook for mid-twenty percent consolidated adjusted segment operating income growth this fiscal year. We're also reiterating our long-term target of a three-year earnings-per-share compound growth rate in the mid-twenty percent range.

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, we would now be pleased to take questions from financial analysts.

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.