OPERATOR: Our first question comes from the line of Hamzah Mazari with Credit Suisse. Please proceed with your question.

HAMZAH MAZARI: Thank you. First question is just on the military business. I know you gave some good colour on some of the programs that you’re on. Maybe if you could just comment on the visibility that you have in that business now relative to the beginning of the year, relative to last year even, and then maybe just talk about how big your emerging market exposure is in military. Thank you.

MARC PARENT (President and Chief Executive Officer, CAE Inc.): I think, Hamzah, in terms of the visibility that we have, I would tell you it’s no different than that I’ve seen in the past few quarters.

The pipeline, as I mentioned in my remarks, remains strong, and quite frankly as strong as I’ve ever seen. So that’s what gives me the confidence that when you put those opportunities of which a lot of them will ascribe a good probability of win on our side, you’re factoring that in and adding that to our backlog, that’s where we come up with our expectations that we continue to grow, albeit modestly in this kind of environment. And the reason I use the term “modestly” is mainly because of frankly, the inability of anyone really to predict when orders will go forward.
But having said that, we do know and have good visibility with programs of record that are going forward. Platforms are being funded in the current funded environment. So if I put all that together, that’s how we come up with our outlook from that sector. But as I mentioned, the next few months we have to secure orders to keep that going. But that’s no different than we were last year. And the visibility, as I mentioned, hasn’t really changed.

In terms of the emerging market exposure, you’ve seen the orders that we’ve secured in the past year, the orders in Brunei, in Malaysia last year, just to quote two of them. I think our footprint is quite good. We have quite a lot of personnel in those countries. What I would tell you is we’re well positioned because from the position that we sit as a Canadian company to start with, historically we’ve not had a very large home-grown market in Canada to sustain military. So by definition we’ve had to be international for quite a number of years. So we’re seeing the fruits of the relationships that we’ve created, and the people that we have around over last years.

So we have pretty good visibility of pipeline of orders, whether it be in the Middle East, in Asia, and feel good about that.

HAMZAH MAZARI: That’s helpful, thank you.
OPERATOR: Our next question comes from the line of Cameron Doerksen with National Bank Financial. Please proceed with your question.

CAMERON DOERKSEN: Hi, good afternoon. I guess a question on capital deployment. You’ve increased your dividend, I think shareholders will be happy to see. You’ve indicated that you don’t really see any more major acquisitions on the at least near-term horizon. And it looks like your capex is going to be lower this year, and presumably maybe going forward as well.

So it looks like you’re going to be generating a fair bit of free cash flow here in the next few years. So I’m just wondering if you think you might be interested in doing a share buyback. I mean, I think you’d probably agree that the current share price is not really reflecting the true value of CAE. So I’m just wondering what your thoughts are on that.

MARC PARENT: Well, I think that you’ve seen us increase the dividend, as you mentioned, for the second time in as many years. And I think that demonstrates both ours and the board’s confidence in the recurring nature of our cash flows and the confidence in business overall. So we consider buybacks, albeit we haven’t done any, we’d consider, we’d say yes to your question. We will see that as another method of addressing shareholder needs for closer returns. So we would definitely consider that. We haven’t done it yet.
CAMERON DOERKSEN: Okay. Thanks very much.

OPERATOR: Our next question comes from the line of Steve Arthur with RBC Capital Markets. Please proceed with your question.

MARC PARENT: Go ahead, Steve.

STEVE ARTHUR: Sorry, can you hear me now?

MARC PARENT: Yes.

STEVE ARTHUR: Okay, sorry about that. Yes, Marc, you made some interesting comments on the Oxford synergies. Then I guess related to that, I’m wondering if you can elaborate a little bit more on some of the capex plans and priorities in that area. With Oxford you took over a large number of generally older simulators, so I was presuming there would be some upgrade work required there. Capex is coming down. So is it fair to assume that there’s less capital required than expected before in the Oxford facilities and/or a slowdown in growth in other training facilities?

MARC PARENT: Well, there’s definitely a slowdown in growth. I just think that what we’re seeing here is something that we anticipated. Of any buyers of this business, because of the install base that we have, there was definitely no other company better situated than us to capitalize on synergies. And one of those is the synergies that you get out of capex, and we’re seeing it.
We’re able to continue to fund the growth, and frankly, some of the growth capex that we plan to deploy this year has mitigated by us being able to, for example, redeploy assets that we have in Oxford that were not fully utilized, as an example.

I can tell you, the next few months there’s at least six of those that are currently being moved to other locations; so that’ll increase utilization on those and obviously increase the revenue per cent that we get.

And in terms of the work that we need to, if you like, freshen up these simulators and other assets within Oxford, sure, there’s some. We had anticipated that. But again, because of who we are in the business, first of all, we’re able to optimize what we need to do to bring those simulators up to par.

And really what you’re talking most of the time is upgrading the configurations to represent the type of aircraft that you’re going to be simulating obviously, say A320 model as an example. So that’s what you’re seeing. And people talk, use this term “older assets”, which is legitimate because the fleet is older, but I always use the example that you take, you get an airline that has an A320 or a Boeing 737 that could be 25 years old, and as a revenue-generating asset, it doesn’t matter how old it is. It’s air-worthy, it’s working. In fact, in a lot of cases it may be more profitable
because of the fact that, for example, it’s fully depreciated. So the same
type of dynamics happen too in our world here.

STEVE ARTHUR: Okay, that’s helpful. Thank you.

OPERATOR: Our next question comes from the line of David Newman with Cormark Securities. Please proceed with your question.

DAVID NEWMAN: Good afternoon, gentlemen.

MARC PARENT: Good afternoon, David.

DAVID NEWMAN: Just on the… looking at the civil side once again, you’ve increased the production of your sims it would appear in the quarter. It looks like you had a bit of a transition as it de-linked with sales with the production side. And now you have 22 million of savings related to Oxford. I guess my question is related to how do you think the margin improvement will be staged in with Oxford as well as the increased production rate? And what do you think the new level of margin improvement could be I guess civil overall and as well as the two divisions within it?

MARC PARENT: Stéphane, you want to comment on that?

STÉPHANE LEFEBVRE (Vice President, Finance and Chief Financial Officer, CAE Inc.): Sure, absolutely. I think, well, as you know, the Oxford itself, as we’ve said it a few times I think in the past couple of weeks, about half of the business is derived from a low-margin type of
business, which is Parc. It doesn’t require capital, but the margins are fairly low. So in my view, I think we can expect a margin dilution of probably at around 3 to 4 per cent for the civil business as a whole. The impact will be probably heavier on the training service segment alone. You may probably see an impact of 5 to 6 per cent, but I’ve looked at it and you can expect, as I said, maybe 3, 3.5 per cent of dilution on the SOI margin for both civil segments.

DAVID NEWMAN: And just on the back of that, just looking at the 22 million, how is that going to be staged in? And then on the increased production rates, how will that be affected in the margins?

MARC PARENT: I think what we’ve said is that the cost synergies will be... we see them ramped up over the next 12 to 15 months and overall, and mainly affecting the civil training business. And based on what we’ve seen, as we mentioned, there’s more synergies, 22 million. And if anything, we’re trending more sort of 12 months than the 15. It’s happening earlier, so you would expect the business, when Stéphane talks about a maybe 3 to 4-per-cent margin dilution, if you were thinking about, as we’ve said before, before Oxford we were talking that the civil business at a peak would be like 22-per-cent margins overall. You saw before Oxford we weren’t too far from that.

DAVID NEWMAN: Yes.
MARC PARENT: So if you take 3 to 4 per cent off, you’re in the 19-per-cent range and you figure that that would be what you’d be looking at when we fully ramped up the cost synergies.

DAVID NEWMAN: Perfect. Thank you.

OPERATOR: Our next question comes from the line of Benoît Poirier from Desjardins Capital Markets. Please proceed with your question.

BENOÎT POIRIER: Yes. Thank you very much. Could you maybe provide more colour about the training opportunity for the U.S. Air Force Tanker Program? When should we hear more news about it and what are your expectations?

MARC PARENT: Yes, sure, Benoît. It’s, as you know, a full and open competition. Bids went in at the end of May 2012. We expect the U.S. Air Force take at least nine months in this environment, maybe a little longer, to select a winner. We’ve bid it as a prime contractor. Now there’ll be a lot of competition on that, so we expect, you know, certainly expect Boeing to bid, Lockheed to bid, L3, FlightSafety, they’ll all be in there. But that’s what that bid, and of course we bid as a prime contractor, we feel good about our bid, but of course it’ll be competitive.

BENOÎT POIRIER: Okay. Thanks for the colour.

MARC PARENT: You’re welcome.
OPERATOR: Our next question comes from the line of Fadi Chamoun, with BMO Capital Markets. Please proceed with your question.

FADI CHAMOUN: Yes, hi. So on capital deployment, I appreciate the comment on visibility of cash that you have. And your payout ratio in dividend is somewhat in the mid 20s now, 26, based on the last 12 months. And I was wondering if this is something you were going to try to maintain on a go-forward basis?

Secondly, in terms of your debt level, you were under 30 per cent or in the low 30 per cent I guess debt-to-capital, and now we're in the high 40. And is there a target that you have in mind, now that you see sort of your business having a little bit more…?

MARC PARENT: Well, let me just…

FADI CHAMOUN: Yes?


FADI CHAMOUN: No, that’s it. Go ahead.

MARC PARENT: Maybe I’ll start with the first part and let Stéphane take it from the target capital structure. In terms of the payout ratio, yes, I recognize a number of you said that. You said… that’s where we wind up. We don’t have a specific policy on it. But clearly, we’ve raised it twice now in the past, as I said, in so many years. And we do want to strike that balance, as I mentioned in my comments about long-term capital
appreciation growth and current returns. So certainly, we don’t have a policy, but it’s not impossible that we do that again. And maybe I’ll leave the second part to Stéphane.

STÉPHANE LEFEBVRE: Yes, absolutely. Yes, on the debt level, Fadi, well as I say, we’re at 40, 48 per cent at the debt-to-capital at the end of the quarter. We used to see in the past around 30, 30 per cent to a third. And when you look back, this allowed us to invest in making the acquisitions that we’ve made in this past year, and I’m thinking of METI and Oxford, and deploy capital in a market, in a debt market that is pretty favourable to us.

Now we’re not at an uncomfortable level at 48 per cent. We’ve even, as I mentioned, renegotiated our credit facility, our revolving agreements with our banks even ahead of maturity.

Now to be prudent, one of the things – Marc talked about the capital allocation – one of the things we want to do with our free cash flow is start de-leveraging the business. I don’t think that we would necessarily target going back at 30 per cent. The debt market is too good at this point in time. But somewhere midway between a third – I guess where we were some time ago – and half, so pretty much half of our capital as we are today would be a very good zone to be in, I think.
FADI CHAMOUN: Okay. And one related follow up: your working capital has been fairly negative for a number of years now. I was wondering if you can give us some colour about what you see happening in the next few quarters on that front?

STÉPHANE LEFEBVRE: Yes, as you know very well, in the first quarter, we’re always… this is a quarter where we spend a lot of our cash on making some annual payments. So you’ve seen us investing in non-cash working capital every Q1 every year. The good news, if I look at the amount of money that we’ve invested in this quarter, 120 million, it’s lower than the 160 million that we had invested in Q1 of last year.

And just looking at some of the elements of that non-cash working cap, you look at the aging of our ARs, for instance, receivables over 60 days, the percentage has improved over time from last year to where we are today. Our investment in project related non-cash working cap is less than last year. Same thing for inventory.

So I think we’re managing that side a little bit more closely than we used to. Are we completely happy with where we are? I think we still want to improve that side, and we’ll keep on managing this. But you’ll always see I guess in the first quarter some dip in cash flow from non-cash working cap, and we will soon, as we did in the past years reverse some of that the remainder of the year.
FADI CHAMOUN: Okay, that’s helpful. Thanks.

OPERATOR: Our next question comes from the line of Turan Quettawala from Scotia Capital. Please proceed with your question.

TURAN QUETTAWALA: Yes, good afternoon. I guess I just wanted to get a sense on, and maybe you can help us understand how the pricing environment is for the civil simulator business. Obviously there’s been some increased competition there, so just if you could give us some colour there, that would be helpful.

MARC PARENT: I think on the training side, it’s pretty stable. On the simulator product side, it depends. It goes opportunity by opportunity. I think we see certainly competitors, new competitors wanting to make a dent in there. But I would not say that overall, the pricing has changed dramatically one way or another. Not that we’ve seen so far, anyway.

TURAN QUETTAWALA: Okay, great. That’s helpful. Thank you.

OPERATOR: Our next question comes from the line of Chris Murray, with PI Financial Corp. Please proceed with your question.

CHRIS MURRAY: Thank you. Good afternoon, gentlemen. Just I guess a quick question on the military segment, and maybe even more specifically the product side. In looking at the way your backlog sort of evolved – and as you said, you had a couple of slower quarters middle of last year, and some good pickup at the end of the year – is there anything
you think you can do to either smooth out or bring ahead some orders just so that you don’t see a revenue drop kind of near term? And if you can give us, just if you can recap how you think the revenue will build through the year. Thanks.

MARC PARENT: I think what you’re seeing – Stéphane, a comment – what you’re mainly seeing in the sim products, civil is it reflects the mix of orders that go through quarter by quarter in terms of the revenue. We have probably about half the backlog in sim product civil that’s made up of long programs, not for example, the next A320, but development programs that tend to have a life that is longer, and where the execution of the revenue is kind of up and down because mainly sometimes as a result of the progress of the aircraft program itself.

But I think that, I mean you could expect that that revenue, because of the increased orders we’ve had over the past year, you’ll gradually see that continue to go up. But it’ll fluctuate a bit. You want to add something?

STÉPHANE LEFEBVRE: That was for sim products civil. Was that your question there, Chris?

CHRIS MURRAY: Yes. What I’m trying to figure out, you basically, as you kind of think about the fact that you’ve got normal delivery cycles, kind of Q2-Q3 last year you had some lower orders. You made it up
in Q4, certainly very strong. And you even had like a C-130 that you guys had pre-built a little bit. What I’m trying to figure out is even for the remainder of this year, if there’s anything you can do to accelerate any of the late orders if you will into earlier period this year?

MARC PARENT: Oh, I’m sorry, you were talking about military. Okay.

CHRIS MURRAY: Yes. Yes.

MARC PARENT: Okay, so I think in terms of accelerating orders, I mean, that’s usually the way to accelerate orders into revenue is through advanced builds. We don’t tend to do that, to be honest. So it’s really a question of for us just securing the orders, executing the backlog that we have. But maybe I’m, I don’t know if I’m getting to the root of your question around the production.

CHRIS MURRAY: Yes. Well, what I’m just trying to understand is as we had these dips in kind of the middle of last year, you kind of think about, you know, you take an order for a simulator. It should start shipping or building. At what point did you start recognizing revenue? There’s a certain timeframe. I’m just trying to think of if there’s anything you can do to accelerate some of those orders you received say in Q4 more towards Q2 as opposed to the back half of the year.
MARC PARENT: Believe me, we try to do that every quarter. We don’t necessarily like the quarter-over-quarter lumpiness that we see. It’s unfortunately inherent in the business. If you look at orders in the military, they tend on average to be larger. You execute one large order, you generate a lot of revenue in one quarter. If you look at last year, it was very backend loaded. So you start producing those. But then you get into shifting on another part of the program, which is more R&D intensive where you’re not rolling that into revenue.

So I really come back, you should look at this on a 12-month viewpoint and the way we’re guiding it, and I think that’s the way to look at it.

CHRIS MURRAY: Okay. Thanks very much, guys.

ANDREW ARNOVITZ (Vice President, Investor Relations, CAE Inc.): Operator, we have time for one more question from investors and analysts; and then we’ll have to open the line to members of the media.

OPERATOR: Ladies and gentlemen, as a reminder, to register for a question, you may press 1 followed by the 4 on your telephone.

We have a follow-up question from Benoît Poirier with Desjardins Capital. Please proceed with your question.

BENOÎT POIRIER: Yes, thank you very much. If we look at the defence side on the military, a lot of companies were very proactive,
including you last quarter with their restructuring. So right now, in light of the current market environment, should we assume anymore restructuring on your side?

MARC PARENT: Not at the moment, Benoît. We did what we thought was required in terms of how we looked at our backlog and anticipated orders. And we tried to put a little buffer there because of how things can fluctuate. So we don’t see any at the moment, but if orders don’t materialize the way we want in any big way, we'll have to do it again. But it’s not anticipated at the moment.

BENOÎT POIRIER: Okay. Thanks for the time.

MARC PARENT: You’re welcome.

ANDREW ARNOVITZ: Okay, Operator, I'd like to thank members of the investment community for their participation and I’d now ask that you open the lines to members of the media.

OPERATOR: And we have no questions from the media at this time.

ANDREW ARNOVITZ: Okay. If that is all, I would like to thank all participants on today’s call, remind you that a transcript of the call can be found on CAE’s website at cae.com. Thank you.
OPERATOR: Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and ask you please disconnect your lines.

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