CAE

REMARKS FOR CAE'S FIRST QUARTER FISCAL YEAR 2020

August 14, 2019

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

<u>Andrew Arnovitz, Vice President, Strategy and Investor Relations</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 for FY20 and answers to questions, contain forward-looking statements. These forward-looking statements represent our expectations as of today, August 14, 2019 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 had a good start to the fiscal year with double-digit revenue and operating income growth and $941 million of orders, for a 1.14x book-to-sales. CAE's total backlog at the end of the quarter was $9.4 billion.

Performance was led by Civil, which delivered strong operating income growth and continued to add significantly to backlog. I'm especially pleased with our market momentum, winning the confidence of our airline and business jet customers with our innovative training solutions.

Defence is more variable on a quarterly basis, and first quarter results reflect this tendency as well as an income growth profile that is more heavily weighted to the second-half of the fiscal year. And in Healthcare, the revenue momentum we saw at the end of last year, continued into the first quarter.

Looking more closely at **Civil**, we booked $694 million of orders in Q1, including multi-year pilot training agreements with airlines including, LATAM, SAS and Air Europa. We also signed a new 5-year pilot training contract with Philippines AirAsia, which incorporates our highly innovative and data-driven CAE Rise™ Training System. Civil sold nine full-flight simulators during the quarter, including: three to Southwest Airlines for the Boeing 737MAX; one to Korean Air for the Airbus A330; and one to Hawaiian Airlines for the Boeing 787. Overall training centre utilization remained strong at 76% on our network of nearly 300 full-flight simulators deployed.

In **Defence**, we booked orders for $220 million, including contracts with Lockheed Martin for C-130J simulators for the U.S. Air Force and U.S. Marine Corps. Other notable orders include a contract with L3 MAS to continue providing in-service support for the Royal Canadian Air Force's CF-18 aircraft, and contracts to upgrade the German Eurofighter and Tornado aircraft simulators. New awards also included contracts for Naval training solutions for the Canadian Surface Combatant program and upgrades to the Swedish Navy’s, Naval Warfare Training System.

And in **Healthcare**, we continued to pursue larger segments of the healthcare simulation market with our expanded salesforce. We announced a new CAE Centre of Excellence for simulation-based education at ESPA-Montreal, which is an innovative healthcare education and industry partnership designed to improve patient care. We also developed and delivered a simulation solution to medical device company, Baylis Medical, to support one of its cardiovascular systems for physicians. As well, we collaborated with the Canadian Association of Schools of Nursing to develop courseware for student nurses practicing with our CAE Juno manikin.

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 $825.6 million, up 14% compared to $722.0 million in the first quarter last year, and **segment operating income** before specific items was $113.3 million, up 15% from $98.5 million last year. Quarterly **net income before specific items** was $63.2 million, or 24 cents per share, which is 8% lower than the 26 cents we reported in the first quarter last year.

Net finance expense for the first quarter was $34.9 million, up from $16.0 million in the first quarter of fiscal 2019. We had higher interest resulting from the long-term debt we issued at the end of last year to fund the acquisition of the Bombardier BAT business. As well, we had higher interest on lease liabilities because of the adoption of IFRS 16.

Income taxes this quarter were $13.0 million, representing an effective tax rate of 17%, which is up from 13% for the first quarter last year. The higher tax rate was mainly due to the impact of tax audits in Canada last year, partially offset by a change in the mix of income from various jurisdictions.

Cash provided by operating activities this quarter was up 18% to $137.8 million, compared to $117.2 million in the first quarter of fiscal 2019. **Free cash flow** was negative $102 million in the quarter compared to negative $86 million last year. We had a higher investment related to inventory and work-in-progress for simulator products to be delivered over the balance of the year, and we had lower payables. We usually see a higher investment in non-cash working capital accounts in the first half of the fiscal year, and 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 $89.0 million, mainly for growth and specifically to add capacity to our global training network to deliver on the long-term exclusive training contracts in our backlog. We continue to expect total capital expenditures for the year to be modestly higher than the prior by about 10-15%. Other uses of cash include the distribution of $25.5 million in cash **dividends**, and we used another $2.0 million to repurchase stock at a weighted average price of $34.41 per common share under the **NCIB** program.

Our financial position continued to be solid with a **net debt** of $2.3 billion at the end of the quarter for a net debt-to-total capital ratio of 49.4%. This reflects the issuance of the unsecured senior notes for the Bombardier BAT Business acquisition, and the higher usage of cash to fund working capital in the first half of the year. Since we adopted IFRS 16 effective April 1, 2019, net debt now also includes obligations under lease contracts which were previously accounted for as operating leases and therefore not included in debt. Excluding this impact, the net debt-to-capital ratio would have been 46.3% this quarter.

Return on capital employed, before specific items and excluding the impacts of IFRS 16, was 12.0% this quarter, a bit lower than the 12.6% last year, as we ramp up the large Bombardier BAT Business acquisition. We continue to target 13% return on capital employed by fiscal year 2022.

Now looking at our segmented performance...

In Civil, first quarter revenue was up 11% year over year to $477.6 million and operating income before specific items was up 29% to $101.0 million, for a margin of 21.1%. From a mix standpoint, simulator product deliveries were lower compared to the first quarter last year, as we expected, while training services growth was especially strong with our expanded capacity. On the order front, the Civil book-to-sales ratio for the quarter was 1.45x and for the trailing 12-month period was 1.54x.

In **Defence**, first quarter revenue of $320.5 million was up 19% over Q1 last year, while operating income was down 30% to $15.1 million, for an operating margin of 4.7%. In Defence, product margins are typically higher than services, and the strong revenue growth in the first quarter was skewed to nearly 2/3 services—and I'd add, mainly on newly awarded service programs that are in the early stages of profitability ramp up. The lower segment operating income in the first quarter reflects this mix, as well as the H2-weighted timing of program milestones we plan to achieve on the higher-margin product contracts already in our backlog. The mix imbalance in the quarter also reflects some variability in the timing of the new product orders we expect to conclude during the course of the year. The Defence book-to-sales ratio was 0.68x for the quarter and 0.83x for the last 12 months.

Lastly, in **Healthcare** we continued to ramp up scale with first quarter revenue of $27.5 million, which is 21% higher than the $22.8 million in Q1 last year. Healthcare segment operating loss was $2.8 million in the quarter, compared to a loss of $1.3 million in Q1 of last year mainly because of a higher investment in SG&A to support a larger business.

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

Marc Parent, President and Chief Executive Officer

Thanks, Sonya;

We continue to see good momentum with our training strategy, which is supported by secular growth trends across all our markets and underpin CAE's investment thesis.

In **Civil**, market fundamentals remain supportive, with long-term passenger traffic growth and an expanding global in-service fleet of aircraft. Civil aviation is a highly regulated industry and the aviation safety imperative underscores the criticality of pilot training. It also brings to bear the essential role that CAE plays in helping to maintain the safety of the global air transportation system. We are a pure-play aviation training company that's well defined as an innovation leader. Our airline customers face evermore complex challenges that require new approaches and comprehensive solutions. We have the largest and broadest global training network, coupled with market-leading simulation products and support. As we look ahead, we expect to see more airline outsourcing opportunities materialize from a large pipeline of long-term training partnerships.

With worldwide demand for approximately 300,000 new first officers forecast over the next decade, CAE is increasingly the partner of choice offering the industry's most comprehensive 'cadet-to-captain' training solutions—and we do this on a global scale. We're actively taking a leadership role to ensure that our industry has the qualified pilots it requires. With women accounting for only 5% of all commercial pilots, we're determined to draw in the full available talent pool. Among several other initiatives underway, the CAE Women in Flight scholarship program encourages women to become professional pilots. We recently announced the launch of a cadet pilot training program where CAE will train more than 700 new professional pilots over the next 10 years for Southwest Airlines' Destination 225 Program. Our collaboration with Southwest is another great example of our commitment to source, train and maintain pilots to support the industry's demand over the long-term.

For Civil overall, we continue to expect operating income to grow in the upper 20-percent range on continued strong demand for our training solutions, including maintaining a leading share of FFS sales, and the integration of the first full year of the Bombardier BAT Business. We expect to complete the integration of this business over the coming quarters and to continue to expand our market addressability with the operators of the nearly 5,000 Bombardier business jet fleet worldwide.

In **Defence**, we're continuing to pursue a large market, with over $4.2 billion of defence proposals in the hands of customers pending decisions. Like Civil aviation, defence forces around the world also face the challenge of training and maintaining sufficient numbers of critical personnel—specifically pilots. I remain encouraged by a large pipeline of opportunities to support our defence customers, and we expect to continue winning our fair share by building on our successes as a Training Systems Integrator. As in previous years, the full-year will be more representative of the Defence segment performance. We continue to expect Defence to generate mid to high single-digit percentage operating income growth this year, as we deliver from backlog and continue to win orders.

And finally, in **Healthcare**, I'm pleased that our new products and strengthened front-end organization are bearing fruit and I'm confident this will continue. For the year, we expect double-digit percentage growth and we remain confident of the long-term prospects for Healthcare to become a more material part of CAE.

In summary, we remain on track to deliver on CAE's growth outlook for the year. We have the benefit of an increasingly recurring base of business in markets with significant headroom for CAE to expand its share, and we look forward to superior top- and bottom-line growth in the years ahead.

Before we conclude, I want to thank Kate Stevenson, who retired from CAE's Board of Directors today. Kate is stepping down having reached our 12-year term limit. During her tenure as a Director, CAE has transformed to become the world's largest civil aviation training company.

I also want to welcome Marianne Harrison who was appointed today as a new CAE Director. Marianne is President and CEO of the John Hancock Life Insurance Company and is a Chartered Accountant and Fellow of the Profession. She brings a wealth of financial and strategic acumen to the role and we look forward to benefiting from her insights and good governance.

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

Andrew Arnovitz, Vice President, Strategy and Investor Relations

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.