CAE

REMARKS FOR CAE’S SECOND QUARTER FISCAL YEAR 2017

November 10, 2016

Time: 1:00 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 FY17 and answers to questions, contain forward-looking statements. These forward-looking statements represent our expectations as of today, November 10, 2016, 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'm pleased with our performance in the second quarter and we're on track to deliver our full-year outlook for growth. Our customers continued to depend on CAE as their training partner of choice, and for the Company overall, we received $747 million in new orders, contributing to a record $6.5 billion backlog.

We continued to make good progress in executing our growth strategy in all three of our business segments. Specifically in Civil, utilization was up six percentage points to 70%, which translated into steady operating income growth. We saw continued robust demand for our training solutions, with new Civil orders totalling $458 million, for book to sales of 1.29 times. We signed long-term training services agreements with airlines including Air Georgian and Japan Airlines, and in business aviation, we signed two notable deals with major aircraft management companies in Europe, including TAG Aviation. We also sold 12 more full-flight simulators bringing us to 21 for the first half, and we ended the quarter with a new record $3.3 billion Civil backlog.

In Defence, we had modest operating income growth and $262 million in new contracts, enabling us to sustain a healthy $3.2 billion Defence backlog and a book-to-sales ratio above one time. Notable awards included continuing training systems and services support on enduring platforms such as the MQ-1 Predator and MQ-9 Reaper unmanned aerial systems, the KC135 aerial refueling aircraft, the MH60R/S helicopter and the T44 light transport aircraft. We also expanded CAE's role on these platforms with training systems modifications, upgraded training materials, and increased instructor support. These contracts are good examples of the increasingly recurring nature of our defence business, and CAE's ability to increase market share within its broad, established customer base.

And in Healthcare, we saw year-over-year revenue growth and higher profitability. We continued to see positive signs that corroborate our market thesis and where CAE can add the most value in healthcare simulation. Notable during the quarter was the sale of our training solutions to a major medical device manufacturer in the U.S., and a collaboration with another medical device manufacturer for point-of-care ultrasound training. And more recently, our Vimedix ultrasound simulator was used as part of an echo examination process for physicians in Europe.

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?

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

Thank you, Marc, and good afternoon everyone.

Consolidated revenue for the second quarter was $635.5 million, and quarterly net income, before specific items of $7.2 million, was $55.5 million, or 21 cents per share. Specific items this quarter involved restructuring completed this quarter, related to the process improvement program that we introduced last year, as well as restructuring, integration and acquisition costs related to the purchase of Lockheed Martin Commercial Flight Training.

Our process improvement program led to the standardization of certain types of commercial aircraft simulators and so we began recognizing revenue upon completion for such simulators this year. As we make this transition, there will be some differences in the timing of revenue and net income recognition between the two accounting methods. For the current second quarter, this change resulted in the deferral of $15.3 million of revenue and approximately one cent of earnings per share. A full reconciliation of these timing differences can be found under 'additional financial highlights' in this morning's second quarter press release.

Free cash flow from continuing operations was $27.3 million for the quarter and for the first half of the year it was $42.8 million, which is up from $40.5 million for the first half of last year. As we had a somewhat higher investment in non-cash working capital in the first half, the increase in free cash flow owes mainly to higher cash from continuing operating activities. As is usually the case for CAE, we expect a portion of the non-cash working capital investment to reverse in the second half of the fiscal year.

Uses of cash during the quarter involved funding **capital expenditures** for $58.8 million, mainly in support of growth. We also distributed $20.3 million in dividends and repurchased and cancelled 829 thousand common shares under the NCIB program, for another $14.3 million.

We continued to maintain a strong balance sheet with **Net debt** of $922.7 million at the end of September for a net debt-to-total capital ratio of 32.1%.

The effective tax rate in the quarter was 16%, which compares to 21% for the second quarter last year, excluding one-time tax items. The lower rate is mainly due a change in the mix of income from various jurisdictions.

Now turning briefly to our segmented performance highlights, **Civil** revenue was $354.7 million and operating income was up 8% to $54.2 million, for a margin of 15.3%.

On an apples-to-apples basis, had these standardized Civil simulators been accounted for under the percentage-of-completion method, Civil revenue would have been $15.3 million higher to $370.0 million, while operating income would have been $3.9 million—or 16%—higher to $58.1 million. On the same basis, the Civil operating margin for the quarter would have been 15.7%, which is a 200 basis point increase year over year.

In **Defence**, revenue grew by 12% over Q2 last year to $253 million and operating income grew by 2% to $29 million, for an operating margin of 11.5%.

And in **Healthcare**, second quarter revenue was $27.6 million compared to $25.4 million in Q2 last year, while segment operating income was $2.6 million compared to $1.5 million in Q2 of last year.

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

Marc Parent, President and Chief Executive Officer

Thanks, Sonya;

Our results for the second quarter and first half of the year add to our confidence in our outlook for growth for the year as a whole. We continue to make good progress on our training partner of choice vision and our strategy, which is focussed on bolstering our competitive moat and growing recurring revenue to achieve superior returns over the long term.

In Civil, we continue to see potential for superior growth and more recurring revenue as we penetrate a greater share of the $3.3 billion global Civil training market. Demand for training, the largest part of our Civil business, is driven primarily by the regulatory requirements associated with the global active commercial fleet and by passenger traffic growth, which continues to track the historical rate of about 4 to 5%. Demand for full-flight simulators also continues to be strong on the back of aircraft deliveries. With another five full-flight simulator orders from a major Chinese airline announced today, we're at 26 year-to-date.

In the business aviation segment, the overall market, as measured by the level of activity of the existing business aircraft fleet, has in aggregate, been relatively stable. That said, we're continuing to make very good progress—as demonstrated by our recent wins with large business aircraft operators in Europe—to increase our share within the existing business jet training market and we see more opportunity for gains ahead.

Overall for Civil, we continue to expect higher demand for training this year to translate into higher annual utilization of our Civil training network. We also look forward to seeing the benefit of our process improvement program, and continue to expect Civil operating income to grow at a low double-digit percentage rate for the year as a whole.

In Defence, activity remains strong with nearly $4 billion of bids and proposals currently submitted and pending with customers. Our backlog involves a higher proportion of long-term training services programs, which augments the recurring revenue nature of our defence business. And our position on long-term, enduring programs provides opportunities for us to increase scope with our broad range of capabilities. We continue to expect modest growth this fiscal year in the Defence segment.

And longer term, we see significant headroom for growth in the defence, supported by secular trends for increased use of simulation-based training and more outsourcing. Given the size of the market and our potential to increase share, CAE is certainly not market constrained. The landscape is positive with defence budgets stabilizing in the West and customers in the Middle East and Asia modernizing and recapitalizing their defence systems. These actions drive the need for training and we believe that CAE is well positioned.

And finally, in Healthcare, we're seeing continued signs that our solutions are becoming increasingly relevant to healthcare professionals as they look for ways to improve safety and efficiency. Just last month, CAE Healthcare, together with the American Society of Anesthesiologists, began to promote our latest innovation at the ASA's annual meeting in Chicago. By leveraging CAE's expertise, we developed a simulation-based solution called, "Anesthesia SimSTAT," which is due for release in 2017. This unique solution has the potential to become a valuable tool for practicing anesthesiologists to earn Credits of Continuing Medical Education. We remain encouraged by the long-term prospects for CAE in the developing healthcare simulation market, and in the short term, our pipeline continues to support our outlook for double-digit growth this fiscal year.

With that, I thank you for your attention. We are 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.