CAE

REMARKS FOR CAE'S FOURTH QUARTER AND FULL FISCAL YEAR 2017

May 31, 2017

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 FY18 and answers to questions, contain forward-looking statements. These forward-looking statements represent our expectations as of today, May 31, 2017, 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 the year, and then Sonya will review the detailed financials. I'll come back at the end of the presentation to comment our outlook for the way forward.

We had strong results overall in the fourth quarter and for the fiscal year, and I'm very pleased with the progress we've continued to make with our training strategy. Our customers responded positively to our innovative solutions, leading to higher utilization of our training network and a $3.2 billion order intake for the year. This gave us a record $7.5 billion backlog, which enhances visibility and augments the recurring nature of CAE's business. Also for the year, we grew net income by 21% and we generated 32% higher free cash flow. All in all, a very good performance.

Looking specifically at **Civil**, we booked $481 million of orders during the quarter for training solutions and 17 full-flight simulators for customers including Shanghai Eastern Flight Training, Donghai Airlines, Korean Air, Ethiopian Airlines and Airbus. For the year, Civil had a record $1.7 billion in orders, which is testament to CAE's position as the training partner of choice. Orders included a total of 50 full-flight simulators, and a range of comprehensive, long-term training agreements with airlines including Vietnam Airlines and Jet Airways. In business aviation, Civil won long-term training contracts with a diverse range of customers, including two large aircraft services and charter companies based in Europe. Overall for the year, Civil grew segment operating income by 15% and filled its training centres to 76% utilization.

Turning to **Defence**, during the quarter, we booked orders for $239 million and received another $233 million in contract options. Notable wins include a training systems integration contract for a comprehensive C295W training solution for Canada's Fixed-Wing Search and Rescue program. This program has an expected value, including options, of more than $300 million over the life of the program. This win is indicative of the increasingly recurring revenue profile of our Defence business. Also during the quarter, Defence was awarded a contract to provide comprehensive aircrew training on the NATO E-3A Airborne Warning and Control System. And we also received an order involving training services for the U.S. Air Force C-130J Maintenance and Aircrew Training System program.

For the year, Defence growth was modest, as expected, and we made good progress converting our bid pipeline into orders. In all, Defence booked a record $1.4 billion in orders in fiscal 2017 and received another $939 million in contract options. This saw our Defence backlog increase by 29% to a record $4.2 billion. This achievement, underscores the strength of our position as a global Training Systems Integrator—or TSI. In addition to the Canadian Fixed-Wing Search and Rescue program, other notable TSI wins during the year included the extension and upgrade of the NATO Flying Training in Canada program, and a comprehensive Naval Training Centre for the UAE Navy.

And finally, in **Healthcare**, financial performance came in below our outlook, mainly because orders took longer to materialize from our sales pipeline than we would have expected. And while we're certainly not satisfied with this result, we made good progress positioning the business for long-term growth. We further distinguished CAE Healthcare's brand through innovation leadership in simulation-based healthcare education and training. Most notably, CAE Healthcare became the first company to bring a commercial Microsoft HoloLens mixed-reality application to the medical simulation market. The CAE VimedixAR ultrasound simulator represents the kind of technological breakthrough one would expect from CAE. We succeeded to integrate real-time interactive holograms of the human anatomy with our ultrasound simulator. It's still early days, but we've already seen strong interest in this new capability.

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 fourth quarter was up 2% to $734.7 million, and quarterly **net income**, before specific items of $15 million, was $82.4 million, or 31 cents per share, representing an **EPS** increase of 15% over the same period last year. Specific items included the remaining restructuring, integration and acquisition costs related to the purchase of Lockheed Martin Commercial Flight Training. For the year, consolidated revenue was up 8% to $2.7 billion, and annual net income before specific items was $278.4 million, or $1.03 per share. Year over year, CAE grew earnings per share by 20%.

There were some timing differences in the quarter with respect to the recognition of revenue on our standardized commercial simulators. This resulted in the deferral of approximately one cent of earnings per share in the fourth quarter, and for the full year, this amounted to approximately three cents of EPS. A reconciliation of these timing differences can be found under 'additional financial highlights' in this morning's press release.

We had very good **free cash flow** performance in the quarter at $160.4 million and for the year overall, free cash flow was up 32% to $327.9 million. This represents a cash conversion rate of 118%. We had a lower investment in non-cash working capital in Q4, as we normally expect in CAE's second half, and we had an increase in cash provided by continuing operating activities.

Uses of cash involved funding **capital expenditures** for $73.6 million in the fourth quarter and $222.9 million for the year, mainly in support of growth. This includes a higher than usual investment in Defence this year, specifically for the U.S. Army Fixed-Wing Training program. We expect a lower capital intensity in fiscal 2018, with total capital expenditures in the range of $150 million, commensurate with market-led opportunities for accretive investment returns.

Other uses of cash included the distribution of **$20.5** million in dividends during the quarter and **$**80.6 million for the year. In addition, we repurchased and cancelled approximately 159 thousand common shares under the NCIB program during the quarter, for another $3.0 million and for the year, we repurchased approximately 2.5 million shares for a total of $41.7 million. In all, between dividends and share buybacks, CAE returned $122.3 million to shareholders during fiscal 2017.

Looking at capital returns, I'm pleased that despite the higher investment in Defence, we improved **return on capital employed** to 11.2% from 10.6% last year. As well, CAE's financial position became even stronger with **Net debt** of $750.7 million at the end of March for a net debt-to-total capital ratio of 26.5%. This is down from $787.3 million or 28.9% of total capital at the end of last year.

Income taxes were $14.8 million this quarter, for an effective tax rate of 17%. This is up from 14% last quarter and down from 24% for the fourth quarter last year. The decrease from last year was due to an audit settlement in Canada and a change in the mix of income from various jurisdictions. Excluding the effect of the settlement, the income tax rate this quarter would have been 22%.

I'll conclude with a few brief comments on our segmented performance.

As expected, **Civil** was the main growth engine in fiscal 2017. Fourth quarter revenue was up 6% year over year to $417.8 million and operating income was up 12% to $83.8 million, for a margin of 20.1%. For the year, Civil revenue was up 9% to $1.56 billion and operating income was up 15% to $273.2 million for an annual margin of 17.5%.

On the order front, the Civil book-to-sales ratio for the quarter was 1.15x and for the trailing 12-month period it was 1.09x. Civil's backlog at the end of the quarter was $3.3 billion, which is up 7% from last year.

In **Defence**, fourth quarter revenue was 4% lower than Q4 last year to $282.7 million and operating income was down 13% to $33.0 million, for an operating margin of 11.7%. For the year, Defence revenue was up 7% to $1.04 billion and operating income was up 1% to $120.4 million, representing a margin of 11.6%. Last year, Defence benefited from non-recurring items reported in our fiscal 2016 Q4 report. Before these items, Defence operating income growth this year would have been approximately 4.5%.

The Defence book-to-sales ratio was 0.84x for the quarter and 1.33x for the last 12 months. Defence backlog at the end of the year reached a record $4.2 billion, which is up 29% year over year.

And in **Healthcare**, fourth quarter revenue was $34.2 million compared to $35.8 million in Q4 last year. Healthcare segment operating income was $4.1 million, or 12% of revenue, in the quarter compared to $3.5 million, or 9.8% of revenue, in Q4 of last year. For the year, Healthcare revenue was $110.7 million compared with $113.4 million and segment operating income was $6.6 million vs. $7.2 million last year.

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

Marc Parent, President and Chief Executive Officer

Thanks, Sonya;

This year, CAE is celebrating the its 70th anniversary. And over the last seven decades, the CAE brand has evolved to become synonymous with training and with innovation. As we look to the year ahead, we expect to see continued good growth as we pursue our vision to be the recognized global training partner of choice.

In **Civil,** pilot training demand is fundamentally driven by the regulations governing the flight crews who operate the global in-service fleet of commercial and business aircraft. So far in 2017, we've seen continued high rates of commercial passenger traffic, which serves as a catalyst to expand the in-service fleet. In business aviation, the market is stable and we're continuing to find growth in support of the existing in-service fleet. Commercial aircraft deliveries are a driver for full-flight simulator sales and there too we see positive signs with major commercial aircraft OEMs still delivering aircraft at high rates. Over the last couple of decades, CAE has established itself as a thought leader in aviation training and we're now bringing to market some of the most innovative and comprehensive solutions that we believe will enable us to unlock a greater portion of the overall $3.5 billion civil aviation training market. For the year ahead, we expect Civil to generate low double-digit percentage operating income growth, as we continue to earn a greater share of wallet in training and we maintain our leadership in simulator sales.

In **Defence**, governments around the world are placing a high priority on mission readiness and the intrinsic benefits of simulation-based training. These factors are driving a greater need for training and we believe that CAE is very well positioned to grow its share as a training systems integrator. Last year, we saw a steady progression with CAE converting a large bid pipeline into orders, and we expect this to translate to mid to high single-digit top and bottom line growth in fiscal 2018, as we ramp up new programs from a record backlog, and win our fair share of new opportunities. We have a robust bid and proposal pipeline, and with defence budget increases anticipated in the U.S. and other NATO and allied nations, we continue to be bullish about CAE's long term prospects in this market.

And finally, in **Healthcare**, we expect to resume growth this year on higher sales from our pipeline and the launch of new products, which will put us on course for long-term double-digit growth. CAE is bringing real value to the healthcare education market, and at the product line level, contribution margins reflect the market's appetite for innovation. The key to our success is higher volume, and the new products we're launching this year will give us more access to some of the largest segments of the market. We have a positive view of CAE Healthcare's long-term potential as the use of simulation expands for education and training, and we remain confident that Healthcare will become a more significant part of CAE's overall business.

In summary, CAE made good progress in fiscal 2017 in terms of overall financial performance, and in terms of enhancing our position for growth in our three core markets of Civil, Defence and Healthcare.

CAE's strategy and investment thesis are based on six interrelated pillars of strength. We benefit from a high degree of recurring business, we have a strong competitive moat, and we have significant headroom in large markets that are being driven by secular tailwinds. These factors, combined with CAE's culture of innovation, give us the potential to generate superior returns. As we look to the period ahead, we take confidence in the strength of our position and the supportive fundaments in our end markets.

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.