CAE

REMARKS FOR CAE’S FIRST QUARTER FISCAL YEAR 2018

August 10, 2017

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

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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, August 10, 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 then Sonya will review the detailed financials. I'll come back at the end of the presentation to talk about the new strategic developments we announced earlier today, and then I'll conclude with some comments about way forward.

Our progress to date in all three segments continues to support our full-year outlook for growth and profitability. The Civil business showed very good momentum in the first quarter with strong top and bottom line growth on good utilization in our training centres. In Defence, although we didn't grow the bottom line in the quarter, I'm satisfied with our progress in view of our full year plan. Defence can be lumpy on a quarterly basis, and in the first quarter we were beginning to ramp up a number of new developmental programs from backlog. Overall for CAE in the quarter, we grew operating profit by 10% compared with last year and we continued to enjoy strong demand from customers to our innovative training solutions.

In **Civil**, we booked $400 million in orders, including eight full-flight simulators, and several long-term training agreements with airlines and business aircraft operators. For the quarter, Civil grew segment operating income by 15% and filled its training centres to 78% utilization.

In **Defence**, we booked orders for $262 million, including a Training Systems Integration contract with the UAE on the Predator XP. Other notable wins include an in-service support contract for Canada's Fixed-Wing Search and Rescue training program and contracts involving C-130J fuselage trainers for the US Air Force and US Marine Corps. We're also very proud that the first cohort of US Army students went through the new Initial Entry Fixed-Wing course at our Alabama training centre and successfully graduated to become Army fixed-wing aviators.

And finally, in **Healthcare**, we had higher expenses in Q1 related to the ramp up of an expanded sales force and the launch of an important new simulator—CAE Juno—which begins delivering in the second quarter. We specifically designed Juno for nursing education, which represents the largest addressable segment in the healthcare education market.

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 first quarter was $698.9 million, and quarterly **net income** was $63.8 million, or 24 cents per share. This compares to 26 cents per share in the first quarter last year, which is before specific items and includes the recognition of a deferred tax item.

There were still some timing differences this first quarter with respect to the recognition of revenue on our standardized commercial simulators. This resulted in the deferral of approximately three cents of Earnings Per Share. For the year as a whole, we expect these timing differences to be relatively neutral as we deliver more of the standardized products.

Income taxes this quarter were $14.6 million, representing an effective tax rate of 18%, compared to nil for the first quarter last year. Excluding the deferred tax item, the comparable tax rate last year would have been 14%.

Free cash flow was typical of CAE's first half of the fiscal year, as we usually have a higher level of investment in non-cash working capital during this period. First quarter free cash flow from continuing operations was negative $37.9 million compared to positive $15.5 million last year. 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 $49.1 million, mainly for growth, and we distributed $21.0 million in cash **dividends.** We used another $2.7 million to buy back stock under the **NCIB** program.

Now looking at our segmented performance…

In **Civil,** we maintained a strong growth in Q1 with revenue up 11% year over year to $411.8 million and operating income up 15% to $73.1 million, for a margin of 17.8%. Before the deferral impact on the recognition of standardized products, Civil revenue and operating income would have been $452.0 million and $83.7 million, respectively, for a margin of 18.5%. On the order front, the Civil book-to-sales ratio for the quarter was 0.97x and for the trailing 12-month period it was 1.07x. Civil's backlog at the end of the quarter was $3.2 billion.

In **Defence**, first quarter revenue was up 2% over Q1 last year to $263.2 million, while operating income was down 7% to $26.3 million, for an operating margin of 10.0%. The quarterly variability we often see in Defence is driven by product/service mix and the timing on reaching certain program milestones. In the first quarter, profitability was impacted by the kick-off of a number of new programs, won late in the last fiscal year, which involved R&D expenses as part of their start-up. To name a few, these include the Canadian Fixed-wing Search and Rescue training program, the UAE Naval Training Centre, and training systems for the Predator XP and Predator Guardian UAVs. As well the business units faced an additional headwind this quarter in the form of higher SG&A expenses. Specifically, the share-based payment expense was $17.5 million, compared to $8.7 million last year. The increase was driven by the sharp appreciation of CAE's shares and the mark-to-market, fair value revaluation of our existing long-term share-based payment plans. Approximately 40% of this total expense was allocated to Defence.

The Defence book-to-sales ratio was 1.0x for the quarter and 1.31x for the last 12 months. Defence backlog at the end of the quarter was $4.1 billion.

And finally, in **Healthcare**, first quarter revenue was $23.9 million compared to $22.7 million in Q1 last year. Healthcare segment operating loss was $1.6 million in the quarter compared to a loss of $100 thousand last year. The loss in the quarter results from higher initial expenses associated with the expansion of our sales force and the development and launch of our new product, CAE Juno.

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

Marc Parent, President and Chief Executive Officer

Thanks, Sonya;

Our outlook for growth this year remains unchanged and I continue to be encouraged by the positive response we get from customers to CAE's innovative solutions. Underscoring our confidence in the way forward, CAE's Board of Directors approved this morning, a one cent increase to our quarterly dividend, which becomes nine cents per share effective, September 29th. This marks our seventh dividend increase in the last seven years.

In **Civil,** pilot training demand continues to be well supported by high rates of commercial passenger traffic and continued stable aircraft utilization in business aviation. This past June, at the Paris Airshow, CAE released its first-ever, *CAE Airline Pilot Demand Outlook*, our 10-year forecast of global pilot demand. A compelling takeaway from this report is the need for 255,000 new airline pilots over the next 10 years. Another important consideration, highly relevant for airlines and CAE, is that half the pilots who will fly the world's commercial aircraft in 10 years' time, have not yet started to train! These dynamics underscore the considerable value of our comprehensive cadet-to-captain solutions.

CAE's broad global offering enables unmatched flexibility to adapt and evolve our solutions to fit our customers' needs. To that point, I'm very pleased with the new strategic developments we announced this morning, involving airlines in Asia.

We signed a Memorandum of Understanding with Singapore Airlines to establish a joint venture to be operated out of the Singapore Airlines Training Centre, near Changi Airport. This marks an important evolution in our relationship with one of the world's premiere carriers. Once underway, the JV will serve the training needs for Singapore Airlines, and SIA Group subsidiaries, SIA Cargo, Silk Air and Scoot, as well as other operators in the ASEAN region.

We also concluded a transaction with China Southern Airlines whereby China Southern has acquired our share of the Zhuhai Flight Training Centre (or ZFTC) for $96 million US. The evolution of this relationship means that CAE now has the flexibility to address the broader market in China and the ASEAN region as well.

As part of the transaction, China Southern will outsource to CAE, third-party airline training being conducted at ZFTC. And in addition, we will continue to serve China Southern as their partner for training services support, ab-initio pilot training, and for their simulation equipment needs.

In response to reports by the media, we confirmed today that CAE and AirAsia are in advanced discussions to negotiate a sale and purchase agreement for CAE to buy AirAsia's 50% share of the Asian Aviation Centre of Excellence joint venture. Our relationship with AirAsia began in 2004, and once a definitive agreement is reached, it would expand with an exclusive contract to fully outsource the fulfillment of all AirAsia Group's training requirements, including current and future affiliates, in support of all aircraft types that it operates for an extended period.

What these developments have in common is that they serve to align our capital with our strategic priorities. They also closely correspond with our investment criteria for accretive growth in support of CAE's 13 percent return on capital target within the next 2 to 4 years. Once completed, these transactions will offer us enhanced flexibility to further strengthen our position in China and the ASEAN region, which are the fastest growing commercial airline markets in the world.

These are indeed exciting times for CAE and our Civil business, as we look to grow our share of the large global aviation training market. Our outlook for the year remains unchanged and we continue to expect Civil to generate low double-digit percentage operating income growth, as we earn a greater share of wallet in training and maintain our leadership in simulator sales.

In **Defence**, we have a solid backlog and we expect to continue winning our fair share of programs from an active bid pipeline of over $3.6 billion. The market is supported by the positive fundamentals of increased defence spending and an emphasis on mission readiness, which is a fundamental driver for training. We're very well positioned to continue growing our share in the large Training Systems Integration market with our unique, comprehensive training solutions. Our outlook for mid to high single digit growth in Defence this year—on both the top and bottom lines—remains unchanged, and we continue to be bullish about CAE's long term prospects in this market.

And finally, in **Healthcare**, we're focussing on some of the largest value pools in the market like simulation-based education and training for nursing. We continue to expect Healthcare 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. As we've said before, the key to our success here is higher volume, and with innovative new products like CAE Juno that we've launched this quarter, and our expanded salesforce, we're confident we can access a larger share of the market.

In summary, we're experiencing a high level of activity in all segments of our business and we're on course to deliver on our outlook for the year.

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.