REMARKS FOR CAE’S THIRD QUARTER FISCAL YEAR 2018

February 9, 2018

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 Arnowitz, Vice President, Strategy and Investor Relations
Andrew Arnovitz, Vice President, Strategy and Investor Relations

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, February 9, 2018, 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 provide an overview of the quarter and then Sonya will review the detailed financials. I’ll come back at the end to talk about our outlook.

We had year-over-year growth in all segments in the third quarter and we remained on track to deliver on our growth outlook for the year as a whole. Some highlights include our order intake of $1.2 billion, which is testament to the good progress we’ve been making to expand our position with airlines, business aircraft operators, and defence forces worldwide. We also generated strong free cash flow in the quarter and maintained our solid financial footing.

Looking specifically at Civil, we booked $1 billion in new orders for our comprehensive training solutions, which marks a quarterly record for the Civil business unit. Orders include exclusive long-term training services for AirAsia, Air Transat, Mesa Aviation, and Jazz Aviation. We also won 26 full-flight simulator orders from airlines including Ryanair, Air France, ATR, Lufthansa Flight Training and Air Canada—some of which involve multi-year deliveries. This brings our year-to-date tally to 45 Civil FFS orders, so we’re on track for another pretty good year. Revenue and operating income were higher than last year’s third quarter, and for the year to date, Civil growth is on track with our outlook.

In Defence, momentum increased in the quarter with revenue and operating income growth in the high single-digit percentages. In terms of order activity, we continued to capture important training systems and services contracts, which put us at $966 million of defence orders for the first nine months of the fiscal year. New awards in the quarter included flight simulators and training systems upgrades for the US Navy’s MH60R aircraft, as well as the German Navy’s P-3C and Sea Lynx flight trainers. Services awards included an enterprise-wide training systems maintenance contract for the Australian Department of Defence.

And in Healthcare, we developed LucinaAR, the world’s first augmented reality childbirth simulator, which we just launched in January at the International Meeting on Simulation in Healthcare in Los Angeles. This new, high-fidelity, patient simulator incorporates mother-baby physiology and is our latest product to integrate the Microsoft HoloLens. Also of note, Healthcare announced a partnership this January with a leading scientific society, the American Heart Association, to deliver AHA certification courses in certain markets.
With that, I'll 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 third quarter was $704 million, and quarterly net income was $117.9 million, or 44 cents per share. This includes approximately 13 cents per share attributable to the US tax reform. Net income also includes a net gain of approximately 3 cents per share on the fair valuation of CAE’s prior investment position in the Asian Aviation Centre of Excellence. This net gain was triggered by our acquisition of the remaining share of the investment and some reorganizational activities. Excluding these elements, earnings per share would have been $0.28, which is up from $0.26 per share last year, before specific items.

Income tax recovery this quarter was $24 million, representing a negative effective tax rate of 25%, which compares to an effective tax rate of 14% for the third quarter last year. Excluding the effect of the US tax reform and the tax impact related to the net AACE gain, the effective tax rate in the third quarter would have been 17%.

Remaining on the subject of tax, we conducted a thorough assessment of the actual and expected future impact of the US Tax Reform, and the good news is they represent a net positive for CAE. A significant portion of CAE’s business is conducted in the United States, where approximately a third of our revenue is generated and a similar proportion of our total workforce resides. The most significant element of the reforms is the lower federal corporate income tax rate which decreased from 35% to 21%, effective January 1. There are a number of puts and takes with respect to other elements of the tax reform, but in aggregate, these reforms will effectively lower CAE’s income tax rate from an annual average of 22% to something more in the range of 20-21% as a rule-of-thumb.

Free cash flow from continuing operations was $146 million for the quarter compared to $124.7 million in the third quarter last year. The increase in free cash flow year-over-year results mainly from a lower investment in non-cash working capital. As is usually the case for CAE, we continue to expect a partial reversal of the first-half investment in non-cash working capital, in the second half of the year.
Uses of cash in Q3 included funding **capital expenditures** for $43 million and **investing** $99.7 million to acquire the remaining 50% equity interest in AACE. We also invested $7.7 million to acquire a 45% interest in Pelesys, forming a joint venture with this leading aviation training courseware developer. In terms of shareholder returns, we distributed $23.2 million in cash **dividends** and we used another $21.8 million to buy back stock under the **NCIB** program. Of note, today, CAE’s Board of Directors approved the renewal of the NCIB under similar terms for another year.

Our financial position continued to be strong with **net debt** of $712 million at the end of the quarter for a net debt-to-total capital ratio of 24.6%. Also, **return on capital employed** increased to 11.7% this quarter, excluding the impact of the US tax reform, compared to 11.2% last quarter.

Now looking at our segmented performance…

In **Civil**, third quarter revenue was up modestly year over year at $413.7 million. We had continued good momentum in training growth and a high level of simulator deliveries as well. Civil’s simulator deliveries were even higher in the third quarter of last year because we were also delivering from the additional simulator backlog that we acquired from Lockheed Martin. In terms of segment operating income, we generated $78.6 million, which includes a $4 million gain on the fair valuation of AACE net of some one-time costs. Before the net gain, segment operating income was up 4% for a margin of 18%.

On the order front, the Civil book-to-sales ratio for the quarter was 2.43x and for the trailing 12-month period it was 1.43x. Civil’s backlog at the end of the quarter was $3.8 billion.

In **Defence**, third quarter revenue was up 8% over Q3 last year to $262.8 million and operating income was up 9% to $32.7 million, for an operating margin of 12.4%. The Defence book-to-sales ratio was 0.71x for the quarter and 1.22x for the nine months year-to-date. The Defence backlog at the end of the quarter was $3.5 billion.

And finally, in **Healthcare**, third quarter revenue was $27.9 million compared to $26.2 million in Q3 last year. Healthcare’s segment operating income was $1.5 million in the quarter compared to nil in the same quarter last year.

With that, I will ask Marc to discuss the way forward.
Marc Parent, President and Chief Executive Officer

Thanks, Sonya;

As I mentioned at the outset, we’re on track to deliver on our growth outlook for the year and I feel very good about the long-term view as well. As is customary for CAE, we’ll provide more on our outlook for the next fiscal year when we report our upcoming fourth quarter.

The Civil aviation training market is large and growing, and we have considerable headroom to expand our position. CAE offers the most comprehensive training solutions, across the broadest global network, and we are widely recognized for our know-how in cadet-to-captain training. With more than 70 years of industry firsts, we’re also seen as a thought-leader in aviation training. This past week at the Singapore Air Show, we launched our latest innovation, the CAE Rise™ training system. This is the first commercial offering of our Next Generation Training System. By leveraging the latest digital technology, we’re able to use real-time data for instructors to objectively assess pilot competencies and gain deep analytical insights into training. We’re in a good position and we have ample opportunity to continue making accretive, market-led, growth investments in our training core that align with our corporate goal of 13% return on capital. For the fiscal year, we still expect to generate low double-digit percentage segment operating income growth and to maintain our leadership position.

In Defence, we are also encouraged by a large pipeline of opportunities in an environment of increasing defence spending and a greater tendency to outsource training. Our innovative solutions, involving integrated live, virtual and constructive training are opening up a large addressable market. Here too, we have plenty of headroom to grow our position. For the year, we maintain our outlook for mid to high single-digit growth, on both top and bottom lines.

And finally, in Healthcare, we’re demonstrating that CAE is the clear innovation leader with a steady cadence of new product releases with which to tap into some of the largest value pools like nursing. We’re still expecting a return to growth this year and to be positioned for double-digit growth beyond.

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.