CAE

REMARKS FOR CAE'S FOURTH QUARTER AND FULL FISCAL YEAR 2019

May 17, 2019

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 FY20 and answers to questions, contain forward-looking statements. These forward-looking statements represent our expectations as of today, May 17, 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. For your added convenience, we have posted a presentation on CAE's website to accompany this discussion of our performance and outlook. It also provides some highlights of the expected adoption by CAE of new lease standard, IFRS 16. You can download this document entitled, "Supplemental Q4 FY2019 Presentation" at www.cae.com/investors.

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 year ahead.

We had an especially strong fourth quarter, as expected, with revenue up 42% and earnings per share up 55% compared to the fourth quarter last year. For the year, we delivered a record performance and we met our growth outlook. Annual revenue grew by 17% and earnings per share grew by 13% and we generated strong free cash flow with a near one-to-one conversion of net income.

Our vision is to be the recognized global training partner of choice and I'm especially pleased with our record $4 billion in annual orders and record $9.5 billion backlog, which underline CAE's positive momentum as the world leader in aviation training. Our continued success winning our customers' trust further validates our training strategy and adds to the highly recurring profile of CAE's business.

Looking specifically at **Civil**, we booked $1.1 billion of orders during the quarter, including an exclusive 15-year training outsourcing agreement with Avianca, and the sale of 28 more full-flight simulators. We also successfully concluded the Company's largest-ever acquisition, involving the Bombardier Business Aviation Training business, which greatly expands our position in this high-value segment.

During the year, Civil booked a record total $2.8 billion in orders, giving it a record backlog of $5.0 billion, which is 22% higher than last year. Notable wins included a 10-year pilot training contract with easyJet, exclusive multi-year pilot training agreements with Asiana and CityJet, and a record total 78 full-flight simulator sales to customers worldwide. Overall for the year, Civil grew segment operating income by 13% and filled its training centres to 76% utilization, while in parallel, adding over 30 new simulators to our network to meet customer demand. In total, CAE's Civil aviation training network now operates over 280 full-flight simulators, from more than 50 locations, and for the first time in our history, last year, we delivered more than one million hours of training! CAE has now become the largest Civil aviation training company in the world.

Turning now to **Defence**, during the quarter, we received orders and contract options totalling $498 million. Notable wins include a contract with Boeing to provide a P-8A Poseidon aircraft simulator for the Royal Air Force; and simulator upgrade programs with the US Navy on the Royal Australian Navy’s MH-60R helicopter training systems, the German Air Force for their Eurofighter simulators, and with Lockheed Martin for C-130J full-mission simulators for the US Air Force.

For the year, Defence grew operating income by 9% and received a total of $1.3 billion in orders and options, which gave us a record Defence backlog of $4.5 billion. Key Training Systems Integration wins during the year include the US Air Force C130H Aircrew Training Services program and the US Navy CNATRA CIS program where we provide instruction at five Naval Air Stations to support primary, intermediate and advanced pilot training. We also won a contract to provide a comprehensive training solution and long-term training services for the Royal New Zealand Air Force NH90 helicopter program, and a contract from General Atomics to develop the synthetic training system for the UK Protector remotely piloted aircraft system. Also during the year, we acquired AOCE, which gave us a position on several U.S. Defense contracts to provide training and engineering support services on higher-level security programs.

And finally, in **Healthcare**, our new simulation products and expanded salesforce led to accelerated revenue growth toward the end of the year. We accomplished a number of strategic objectives during the year to enable future growth, including the launch of innovative products like, CAE Ares, our emergency care manikin for nursing, and CAE Luna, an innovative infant simulator for clinical training of neonatal and infant care. Most recently, we appointed a new Healthcare leader, Rekha Ranganathan, who brings deep commercial experience in healthcare to leverage our current accomplishments and take Healthcare to greater scale and profitability.

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 42% to $1.0 billion, and quarterly **net income before specific items** was $127.5 million, or 0.48 cents per share, which is up 55% compared to 0.31 cents in the fourth quarter last year.

For the year, consolidated revenue was up 17% to $3.3 billion, and annual net income before specific items was $335.2 million, or $1.25 per share, which is up 13% compared to $1.11 last year. Specific items in fiscal 2019 include the costs from the acquisition and integration of Bombardier's BAT Business. Specific items in fiscal 2018 include the income tax recovery related to the U.S. tax reform and net gains on strategic transactions involving our Asian joint ventures.

We generated $116.8 million of **free cash flow** in the quarter and $323.8 million for the year, for an annual cash conversion rate of 98%, which is in line with our annual average conversion target of 100%.

During the year, we had a lower investment in non-cash working capital, and generated higher earnings which converted into higher cash provided by operating activities. Overall, a good year from a cash flow standpoint and we expect to continue our focus on maintaining non-cash working capital efficiency in the year ahead.

Uses of cash involved funding **capital expenditures** for $96.2 million in the fourth quarter and $251.8 million for the year, mainly for the deployment of new simulators to our global training network in support of customer-led growth opportunities. In line with the customer-driven, accretive investment opportunities that we see, we expect modestly higher CAPEX in fiscal 2020, increasing by about 10-15%, primarily to keep pace with growing demand for training services from our customers and to secure new long-term customer contracts and outsourcings. Our existing asset base generates a high level of recurring cash flow, and in addition, the simulators we’ve deployed to our network in support of growth over the last five years have typically ramped up within about 24 months to generate accretive incremental returns and free cash flows.

Other uses of cash included the distribution of $99.9 million in dividends for the year. In addition, we repurchased and cancelled approximately 3.7 million common shares under the NCIB program during the year, for another $94.4 million. In all, between dividends and share buybacks, CAE returned $194.3 million to shareholders during fiscal 2019, which represents a 44% increase over last year.

Looking at capital returns, we have essentially already reached our 13% multi-year **return on capital employed** target with an increase to 12.9% from 12.7% last year, excluding the impacts of specific items. We're maintaining our 13% ROCE target by fiscal year 2022 as we now integrate and ramp up the Bombardier BAT Business acquisition and continue to fund accretive growth opportunities.

Net debt was $1,882.2 million at the end of March, for a net debt-to-total capital ratio of 43.9%. This compares to $649.4 million or 22.0% of total capital at the end of last year. The increase is mainly from the additional funding we required for the BAT acquisition and the monetization of our existing future royalty obligations. We issued US$450 million of unsecured senior notes and US$150 million term loans, and with our continued strong cash generation, we expect to deleverage to the lower end of our net debt-to-capital target range of 35% to 45% within 24 to 36 months.

In terms of **interest expense**, the quarterly run-rate in fiscal 2020 should be in the range of approximately $30 million, which takes into account the additional debt as well as the treatment of leases under IFRS 16.

Income taxes in the fourth-quarter were $19.3 million, representing an effective tax rate of 13%, compared to 8% for the fourth quarter last year. The higher rate this quarter results from a change in the mix of income from various jurisdictions and a higher recognition of deferred tax assets in Europe last year. We recognized deferred tax assets in Canada this fourth quarter but these were mostly offset by tax audits. Before these items, the income tax rate would have been 20% this quarter, and on the same basis, the income tax rate for the year would have been 19%.

Now turning to our segmented performance.

In Civil, fourth quarter revenue was up 50% year over year to $593.4 million on higher training services volume and a high number of simulator deliveries. Operating income before specific items was up 64% to $122.3 million, for a margin of 20.6%. For the year, Civil revenue was up 15% to $1.9 billion and operating income before specific items was up 13% to $351.1 million for an annual margin of 18.7%. The Civil book-to-sales ratio for the quarter was 1.87 times and for the year it was 1.48 times.

In **Defence**, fourth quarter revenue of $387.9 million was up 34% over Q4 last year, resulting from higher services activity and some good progress made on products-related programs. Excluding the impact of acquisition and integration costs related to the purchase of AOCE, fourth quarter operating income was up 42% to $51.7 million, for an operating margin of 13.3%. For the year, Defence revenue was up 21% to $1.3 billion and operating income, before the AOCE-related expenses, was up 9% to $134.8 million, representing a margin of 10.3%. The Defence book-to-sales ratio for the quarter was 0.68 times and for year it was 0.83 times. Defence contracts often include contract options that go beyond the initial year of the contract—especially in the US. So, the book-to-sales ratio including options for the quarter was 1.28 times, and on the same basis, for the year it was 1.03 times.

And in **Healthcare**, fourth quarter revenue reached a new high of $40.7 million, up 16% from $35.1 million in Q4 last year. Healthcare segment operating income was $4.2 million, or 10.3% of revenue, in the quarter compared to $6.7 million, or 19.1% of revenue, in Q4 of last year. For the year, Healthcare revenue was $121.6 million, up from $115.2 million, and segment operating income was $4.8 million, or 3.9% of revenue, down from $8.8 million last year, or 7.6% of revenue last year. The lower operating income was mainly because of higher expenses related to the salesforce expansion.

Before I turn the call back over to Marc, I'll say a few words about the new accounting Standard **IFRS 16**, relating to *Leases*, which CAE adopted as of April 1, 2019.

This standard changes the way we account for leases which are currently classified as either a finance lease, which is recorded on balance sheet, or as an operating lease which is off balance sheet and expensed as incurred. Under the new standard, all leases will now be recorded on balance sheet as a "right-of-use asset" and a "lease liability", included in long term debt. This change impacts the timing and nature of expenses related to lease contracts. Rent expense under the current lease standard will now be replaced by interest and amortization expense. CAE has adopted this standard using the modified retrospective application and so we won’t be restating fiscal 2019 results for the impacts of IFRS 16.

IFRS 16 is expected to have a negative one cent EPS impact on our fiscal 2020 financial results. We provide additional detail of the expected impacts in note 2 of our annual consolidated financial statements and in our ‘Supplemental Q4 FY2019 Presentation.’

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

Marc Parent, President and Chief Executive Officer

Thanks, Sonya;

CAE continues to benefit from secular tailwinds in our markets and we’re well positioned for sustainable, profitable growth. As we look ahead, we will continue building on our positive momentum as the trusted partner for our customers. We expect to continue exceeding underlying market growth as we deliver on a record backlog and convert a large pipeline into higher market share and new enduring customer partnerships.

Beyond the solid foundation of the financial results and record-setting orders and backlogs we just reported, I am highly encouraged by the continued evolution of CAE’s strategy to garner sources of growth and long-term competitive advantage. The management team and I, last month, completed our annual strategic review with CAE’s Board of Directors and we are indeed very enthusiastic about the company’s prospects to continue growing and generating attractive returns in large markets where CAE benefits from an excellent position and a high degree of recurring business.

In **Civil**, we expect to continue growing our market share, as the training partner of choice, with our innovative solutions. Market fundamentals remain supportive with continued passenger traffic growth and an expanding global in-service fleet of aircraft. CAE is a pure-play training company that's well defined as an innovation leader. We have the largest and broadest global training network, market-leading simulation products and support, and the most comprehensive offering of cadet-to-captain training solutions. And we're now differentiating even more with new data-driven solutions that provide our training customers with powerful new tools and deeper training insights than previously thought possible. We currently have an active pipeline of airline outsourcing opportunities, and I believe our well-differentiated position gives us even greater potential for more long-term, recurring training partnerships for CAE. In business aviation, we're also bringing Digital to the fore, pushing the boundaries of aviation training, and enhancing our customers' experience. The BAT acquisition is transformative for CAE and as we now integrate this business, it will expand our market addressability to include operators of the nearly 5,000 bombardier business jet fleet worldwide.

In the year ahead, for Civil overall, we 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.

In **Defence**, the market is also highly supportive with governments around the world placing a high priority on mission readiness and looking at outsourcing to partners like CAE to help create and maintain critical operations personnel. Here too, we're seeing good momentum as we convert a large bid pipeline into orders. We expect to gain a bigger share as a Training Systems Integrator with current bids and proposals pending customer decisions at over $4.5 billion. We're demonstrating our ability to bid and win as a top-tier Training Systems Integrator in our traditional air domain and increasingly in Naval. The most recent example being the selection of the Lockheed Martin-led team for the Canadian Surface Combatant ship program, where CAE will play a key role in Canada's largest-ever defence procurement, initially to perform training needs analysis and to provide engineering support. The CSC program will further extend our experience in the naval domain to develop and deliver TSI solutions to Naval customers globally.

For the year ahead, we expect Defence to generate mid to high single-digit percentage operating income growth as we deliver from backlog and continue to win opportunities from a large pipeline.

And finally, in **Healthcare**, our new products and strengthened front-end organization show a lot of promise, and I'm confident that there's a large enough market for CAE to build on the innovations CAE Healthcare has already fielded and achieve greater scale. Healthcare has been and will continue to be self-funding as we expand its market reach and bring new solutions to market. Adding to my confidence that we can make this a material part of CAE is our new healthcare leader, who has a proven track record of rapid and sustained business growth in the healthcare industry. We maintain a positive view of CAE Healthcare's long-term potential, and for the year ahead, we expect double-digit percentage growth.

In summary, we look forward to superior and profitable growth. We have the benefit of an increasingly recurring base of business in markets with significant headroom for CAE to expand its share. In the period ahead, we will continue to prioritize accretive growth opportunities, balanced with cash returns to shareholders and maintaining a strong financial position.

We take great confidence in the strength of our talented employees and our position as an innovation leader, and increasingly, the recognition of CAE by customers as the worldwide training partner of choice.

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.