

THOMSON REUTERS STREETEVENETS

EDITED TRANSCRIPT

CAE.TO - CAE Inc to Acquire Bombardier Business Aircraft Training
Conference Call

EVENT DATE/TIME: NOVEMBER 08, 2018 / 12:15PM GMT



CORPORATE PARTICIPANTS

Andrew Arnovitz CAE Inc. - VP of IR & Strategy

Marc Parent CAE Inc. - President, CEO & Director

Nick Leontidis CAE Inc. - Group President of Civil Aviation Training Solutions

Sonya Branco CAE Inc. - VP of Finance & CFO

CONFERENCE CALL PARTICIPANTS

Benoit Poirier Desjardins Securities Inc., Research Division - VP and Industrials, Transportation, Aerospace, Industrial Products & Special Situation Analyst

Christopher Allan Murray AltaCorp Capital Inc., Research Division - MD of Institutional Equity Research & Senior Analyst

Kevin Chiang CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Analyst

Kristine Tan Liwag BofA Merrill Lynch, Research Division - VP

PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to CAE Conference Call. Please be advised that this call is being recorded.

I would now like to turn the meeting over to Andrew Arnovitz. You may now proceed, Mr. Arnovitz.

Andrew Arnovitz - CAE Inc. - VP of IR & Strategy

Good morning, everyone, and thank you for joining us. Before we begin, I'd like to remind you that this morning's remarks contain forward-looking statements, including without limitation, as it relates to our proposed acquisition of Bombardier's Business Aviation Training business, as well as certain expectations with respect to the same. These forward-looking statements represent our expectations as of today, November 8, 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. Please refer to Slide 2 of our investor presentation, which can be downloaded on our website for a detailed description of the cautions and risk factors pertaining to the proposed acquisition and related forward-looking statements.

On the call with me this morning are Marc Parent, CAE's President and Chief Executive Officer; Sonya Branco, our Chief Financial Officer; and Nick Leontidis, CAE's Group President of our Civil segment. 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'll open the line to questions from members of the media. Please link to the investor presentation that we've prepared for your reference. You may wish to use it to help guide this morning's discussion. It's available in the Investors section of CAE's website or by clicking the link in this morning's press release.

Let me now turn the call over to Marc.

Marc Parent - CAE Inc. - President, CEO & Director

Thanks, Andrew. And thanks to everyone for joining us on this early morning call. It's an exciting day for CAE. This morning, we announced that CAE will acquired Bombardier's Business Aircraft Training business to expand our position in the large and growing business jet training market. This marks another important step in realizing CAE's vision to be the recognized worldwide training partner of choice. I'll first say a few words about



the strategic rationale behind our decision and describe how this will benefit CAE shareholders, and then, Sonya will walk us through a summary of the transaction details.

This agreement between Bombardier and CAE is a win-win that enables both companies and even greater focus on our respective core businesses. One of the main benefits for CAE in this transaction is that we'll have a significantly expanded ability to address the training market for the active fleet of more than 4,800 Bombardier business jets, many of them in the higher value medium and large-cabin segments. The acquisition gives us a well-established and growing business for the provision of all flight and maintenance training for business jet operators worldwide.

Also as part of our agreement, we will extend our authorized training provider status with Bombardier out to 2038. The acquisition provides CAE with talented people, our portfolio of customers and an established recurring training business, which is highly complementary to CAE's network. The Bombardier Business Aircraft Training business includes a modern fleet of full-flight simulators and training devices, covering Learjet, Challenger and Global product lines, including the latest large-cabin Global 5500, Global 6500 and Global 7500 business jets.

From a strategic standpoint, the transaction fits right in our core and aligns very well with CAE's larger training strategy. One of our main strategic objective as a company is to grow recurring revenues and in civil, specifically, to increase with wet or structure-led training. The acquisition gives us exactly that, an expanded addressable market for business jets, which is 100% wet training and the ability to leverage our expanded position on Bombardier business jet platforms across the entire CAE global network.

The customer installed base will now have the benefit of accessing training at 7 locations worldwide. Currently, the Bombardier Business Aircraft Training business operates from 2 locations, one in Dallas and one in Montreal. The operations are already co-located within CAE's training centers, which makes for a smooth plug-and-play integration.

In summary, we look forward to addressing a large and growing market of Bombardier business jet operators and providing them with a world-class training experience. Market fundamentals of business aviation are strong with increased aircraft utilization and higher expected deliveries of new aircraft. And the business we're acquiring is well supported by a large installed base.

We're expanding our position in the largest and fastest growing segment of business aviation training at an opportune time. And this is an attractive opportunity for CAE to acquire an established business with a high growth profile and attractive margins. The transaction will provide CAE with positive earnings and free cash flow accretion, beginning in the first full year, following the closing of the acquisition.

With that, I'll now turn the call over to Sonya to take us through the transaction summary.

Sonya Branco - CAE Inc. - VP of Finance & CFO

Thank you, Marc, and good morning, everyone. This transaction aligns well with our capital allocation strategy, which prioritizes accretive growth investments in our core, cash returns for shareholders and a strong financial position. With this transaction, our capital allocation strategy remains unchanged and we maintain our visibility to 13% return on capital employed within our guided time frame by fiscal 2022.

There are 2 main components to the transaction. The first being the acquisition of Bombardier Business Aircraft Training, or BAT, for an enterprise value of \$645 million. Using forecasted 1-year forward EBITDA, this represents a purchase multiple of about 9x. This takes into account about \$6 million of annual cost synergies that we expect to reach within our first year.

On a trailing 12-month basis using an adjusted EBITDA, this equates to about 10x multiple. It's important to note that of the 12 full-flight simulators acquired as part of the BAT business, one of them, for the Global 7500 was just recently deployed and another 7500 will be deployed in December. And one additional simulator for the Global 6500 is scheduled to be deployed in our fiscal year 2021. We expect the business to generate double-digit growth, driven in large part by demand from the existing large installed base of Bombardier business jet operators worldwide and the ramp up of the recently-deployed or soon-to-be-deployed high-value training platforms.



The second part of the transaction involves the monetization of existing future royalties, and the extension of our ATP agreement to 2038. We have agreed to pay \$155 million as the discounted sum of CAE's royalty obligations to the OEM for the next 20 years. The opportunity to extend the ATP and prepay these obligations at a discount, provides good value for CAE and its shareholders. We expect the transactions to be accretive to the Civil segment operating margin by about 100 to 150 basis points. And for CAE, overall, for it to be high-single-digit percentage accretive to earnings in the first year, following closing. And it will also be free cash flow accretive in the first year.

Financing for the transaction is fully committed and we are financing it with a combination of new committed term loans of up to \$400 million, as well as cash on hand in our existing credit facility. CAE's target leverage ratio is 35% to 45% net debt to total capital. And with this acquisition, it will remain within this range at approximately 42% pro forma at closing. These assets generate a high level of free cash flow and our plan is to bring leverage back down to the lower end of the target range within 24 to 36 months, post closing. CAE is and will remain an investment grade profile, which enables us to maintain our financial flexibility and access to debt markets at attractive terms.

In terms of timing, the transaction is subject to customary regulatory approvals. We expect to close on the monetization transaction by the end of our fiscal year and to close on the BAT acquisition by the second half of calendar 2019.

With that, I thank you for your attention. We are now ready to answer your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from the line of Chris Murray with AltaCorp Capital. Please proceed.

Christopher Allan Murray - *AltaCorp Capital Inc., Research Division - MD of Institutional Equity Research & Senior Analyst*

A couple of quick questions for you. First on the simulators that you're acquiring, is it fair to think that all of those are actually a CAE build or there -- will there be mix of different equipment that you'll be acquiring?

Marc Parent - *CAE Inc. - President, CEO & Director*

It's Marc, Chris. They're all CAE, except for one which was built many years ago. I sat with Phil Bombardier at the time, and it was built by NLX, which is a company that no longer exists as a separate entity.

Christopher Allan Murray - *AltaCorp Capital Inc., Research Division - MD of Institutional Equity Research & Senior Analyst*

Okay, great. So no problem with the equipment then. All right. And then the other question for you on the --.

Marc Parent - *CAE Inc. - President, CEO & Director*

[Multiple Speakers]

Sonya Branco - *CAE Inc. - VP of Finance & CFO*

I could just add to it. So, most of these as Marc just said are CAE manufactured simulators. It's very complementary to our existing network and they're very modern, young simulators that are quite a cutting-edge and don't expect a lot of maintenance CapEx going forward. But what I would



direct is, in addition to these simulators, really what we're buying is -- buying a stream of incremental revenue and EBITDA, cash flows and existing portfolio of contracts and customers that are growing at a double-digit pace. They happen to be served by 12 simulators, but really we're buying an ongoing concern business.

Christopher Allan Murray - *AltaCorp Capital Inc., Research Division - MD of Institutional Equity Research & Senior Analyst*

I appreciate that. And I'm assuming that all the staff and everything will transfer with it as well?

Marc Parent - *CAE Inc. - President, CEO & Director*

Yes.

Sonya Branco - *CAE Inc. - VP of Finance & CFO*

Yes.

Christopher Allan Murray - *AltaCorp Capital Inc., Research Division - MD of Institutional Equity Research & Senior Analyst*

Okay, perfect. If you could, can you give us any indication -- you talked about getting back to a 13% ROCE. Any thoughts around, or guidance around what the discount rate look like to justify the taking the royalty stream and turn it into a lump sum payment. Is there something that actually helps you hit that target that comes from that position?

Sonya Branco - *CAE Inc. - VP of Finance & CFO*

I think this was a very attractive transaction for us because it allows us to extend our ATP agreement for until 2038. And these were existing contractual cash flows and not incremental cash flows. So the prepayments allowed us to discount that at a discount that is higher than our cost of capital and so attractive value for CAE. So this, in addition to the business, which provides a strong free cash flow, accretive earnings will contribute to ramp up the ROCE target, return on capital of 13%.

Operator

(foreign language) Benoit Poirier, Desjardins Capital Markets. Please go ahead, sir.

Benoit Poirier - *Desjardins Securities Inc., Research Division - VP and Industrials, Transportation, Aerospace, Industrial Products & Special Situation Analyst*

Could you talk a little bit about business jet, in terms of market share that you will have post this transaction in terms of number of simulators versus your -- the #1 competitor in the space. And also talk about the synergies, quantify the number of synergies that could exist with your current training footprint in Dallas and Montreal. Thank you.

Marc Parent - *CAE Inc. - President, CEO & Director*

We'll just start with the synergies. Maybe, Sonya, you want to take that one?



Sonya Branco - CAE Inc. - VP of Finance & CFO

Yes, so on the synergies, we've specified that we expect to have about \$6 million in annual synergies. And this really comes from the fact that both operations are highly complementary and we are buying this business to support our growth. So we expect a good integration due to the fact that the operations are co-located, and we're also very close on the operations. Now, there will be some synergies mostly coming from cost efficiencies and infrastructure and back office costs like IT costs. There are some redundancies and positions, but we are a growing company and have many open positions. So we're confident that there are plenty of opportunities across the organization for any of the impacted positions.

Marc Parent - CAE Inc. - President, CEO & Director

Then, with regards to market share, maybe I'll just cover in terms of the amount of business aircraft simulators. Nick, maybe --?

Nick Leontidis - CAE Inc. - Group President of Civil Aviation Training Solutions

Yes. So today we have 18 Bombardier model simulators in the network and we're going to add 11. So, that will bring us up to 29.

Marc Parent - CAE Inc. - President, CEO & Director

And then there's 1 to follow.

Nick Leontidis - CAE Inc. - Group President of Civil Aviation Training Solutions

And then there's 1 to follow, so that takes us to 30 and that's out of fleet of about 80 simulators. So a pretty significant amount of our sims already have been Bombardier. So just a little bit more.

Benoit Poirier - Desjardins Securities Inc., Research Division - VP and Industrials, Transportation, Aerospace, Industrial Products & Special Situation Analyst

Okay. And what about the average fleet of Bombardier's training simulators. What's the relatively average age?

Marc Parent - CAE Inc. - President, CEO & Director

Average age of the simulators?

Benoit Poirier - Desjardins Securities Inc., Research Division - VP and Industrials, Transportation, Aerospace, Industrial Products & Special Situation Analyst

(inaudible) pretty new, Marc, as far as --.

Sonya Branco - CAE Inc. - VP of Finance & CFO

Yes, it's a very new fleet, the average age is about 7 years. So very new, modern fleet.

Operator

And our next question comes from the line of Kristine Liwag, Bank of America Merrill Lynch. Please go ahead.



Kristine Tan Liwag - *BofA Merrill Lynch, Research Division - VP*

Sonya, I think on your prepared remarks, you mentioned that the deal is margin accretive to the Civil segment. So I just wanted to confirm that, first that's what you said. And then second, can you give us an understanding of why this business would be accretive to what you already have. Is there a difference in mix, and let us know what's kind of driving the difference there?

Sonya Branco - *CAE Inc. - VP of Finance & CFO*

So, to your first question, what we see is strong growth, double-digit EBITDA growth on demand from a large installed base of business jet operators and the ramp up of newly deployed and soon-to-be-deployed simulators, as well as leveraging and expanding these training platforms across our global network. So what we see on the Civil side is an expansion of margin about 100 to 150 basis points. And really what that reflects is a higher preponderance of BAT on the Civil portfolio and business aviation training is generally a multiple more in revenue and margin given that it's all wet, so instructor-led training and so that is a higher yield.

Kristine Tan Liwag - *BofA Merrill Lynch, Research Division - VP*

And then, is there customer overlap between your customers today and the new business you're buying?

Nick Leontidis - *CAE Inc. - Group President of Civil Aviation Training Solutions*

Yes. So this is Nick. There is definitely a lot of overlap between the customers that this business serves and ours. I think just to your previous question, the business -- acquiring this business expands the addressability that we have. And so it's all about being able to serve all the different platforms that Bombardier has either in production today or had in production in years gone by. So typically, a customer will come to one provider for all of these. So when we bought this business, we expand what we have and we call that halo, but it's really our halo, but very many common customers.

Kristine Tan Liwag - *BofA Merrill Lynch, Research Division - VP*

Sure. And last question from me. Can you guys provide some color on how the deal came about? Is this something that you approached Bombardier to acquire, or is it something that they approached you to sell?

Marc Parent - *CAE Inc. - President, CEO & Director*

No, we approached Bombardier. I mean, it's a natural extension of the ongoing relationship that we've had with Bombardier. We are their authorized training provider on essentially all of their business jets. So, this is an extension of the relationship. We proposed it, I mean, as you've seen us do in the market overall for CAE, we just recently acquired the remaining 50% of the joint venture of Air Asia Training Center on the commercial side. So it's something that we've been doing. Again along the way of fulfilling our vision to be the training partner of choice and acquiring scale on this business on a much expanded scale across business aircraft which is really the sweet spot of our business, especially on the large cabin business jets.

Operator

(Operator Instructions) We now have a question from the line of Kevin Chiang from CIBC. Please proceed with your question.



Kevin Chiang - CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Analyst

Just in terms of the assets you acquired, I'm wondering about the 2 sites that you're folding in. What's the utilization of those sites today? I guess if I had to look at the trailing multiple you're calling about 10x EBITDA, so that's about, let's call it \$65 million of EBITDA you acquiring on a trailing 12-month basis. Just wondering what that infers from a utilization perspective for those 2 sites?

Marc Parent - CAE Inc. - President, CEO & Director

I know utilizing is very high. Do you have any numbers, by any chance, Nick?

Nick Leontidis - CAE Inc. - Group President of Civil Aviation Training Solutions

No, we don't have the numbers.

Marc Parent - CAE Inc. - President, CEO & Director

No. We don't have the number off hand. But it's suffice to say that the utilization of simulators is pretty high.

Nick Leontidis - CAE Inc. - Group President of Civil Aviation Training Solutions

Except -- Marc, I would just add that we have 9 simulators in the network today that are, I think, running a pretty good utilization rate. 1 was just installed recently on the 7500, another 7500 goes in this coming December. And then, there's a 12 simulators going in our fiscal '21. So, a lot of headroom on those very high-value large-cabin models coming into the mix.

Marc Parent - CAE Inc. - President, CEO & Director

I think what we would say is, it's pretty comparable to what we have in the numbers that you see in our utilization.

Kevin Chiang - CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Analyst

Okay. That's helpful. And then, just a housekeeping one here. I think your normalized CapEx has been around \$125 million to \$150 million of let's call it, maintenance CapEx. Does that change dramatically with this acquisition?

Sonya Branco - CAE Inc. - VP of Finance & CFO

No, it doesn't. As we mentioned, it's a pretty young fleet. And so, this would not have a significant impact.

Kevin Chiang - CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Analyst

Okay. And then, I know you maintained -- last one here. I know you maintained your 13% return on capital employed outlook by fiscal year 2022 there. But if I were to think of the fact that you're folding in a more profitable business, that doesn't seem like it's adding to the capital intensity. I'm just wondering, when you look at that target, the opportunity to reach that target earlier or to have that target pierce above the 13% over the next 3 to 4 years you're given the attributes of the assets you're acquiring today?



Sonya Branco - CAE Inc. - VP of Finance & CFO

So, we've taken that into consideration in the guidance that we've provided. We've seen significant progress in past few years, climbing up to 12.6% last quarter by deploying market like capital to our network that becomes accretive in short order. Of course, in the very short term, there will be a bit of a headwind, given acquisition simulators, intangibles to digest. But as you said, the strong accretion in this business, the cash flow it brings will allow us to ramp up to that target by FY22.

And if I may add, the free cash flow will help us also delever back to the lower end of the target range within 24 to 36 months.

Operator

Thank you for your question. We are now going to proceed to the question-and-answer session for the press and media. (foreign language) (Operator Instructions) (foreign language) Please go ahead.

Unidentified Participant

(foreign language)

Marc Parent - CAE Inc. - President, CEO & Director

(foreign language)

Unidentified Participant

(foreign language)

Marc Parent - CAE Inc. - President, CEO & Director

(foreign language)

Unidentified Participant

(foreign language)

Marc Parent - CAE Inc. - President, CEO & Director

(foreign language)

Sonya Branco - CAE Inc. - VP of Finance & CFO

(foreign language)

Marc Parent - CAE Inc. - President, CEO & Director

(foreign language)



Operator

(foreign language) (Operator Instructions) (foreign language)

Andrew Arnovitz - CAE Inc. - VP of IR & Strategy

Operator, if there are no other questions, we can conclude this morning's call. I want to thank everyone for joining us, especially, so early, and remind you that a transcript of today's call can be found on CAE's website, as well as a supplemental investor presentation, which is linkable from this morning's press release or found in our Investors section of CAE's website. Thank you very much.

Operator

Thank you. Ladies and gentlemen, that does conclude the conference call for today. We thank you all for your participation and ask that you please disconnect your lines. (foreign language) Have a great day.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2018, Thomson Reuters. All Rights Reserved.