

**Q1FY16 CONFERENCE CALL WITH ANALYSTS**  
**Q&A transcript**  
**August 12, 2015**

Operator: Thank you.

Ladies and gentlemen, if you would like to register a question, please press the one followed by the four on your telephone. You will hear a (three-tone) prompt to acknowledge your request. If your question has been answered and you would like to withdraw your registration, please press the one followed by the three. If you are using a speakerphone, please lift your handset before entering your request. One moment please for the first question.

And our first question comes from the line of Steve Arthur with RBC. Please proceed with your question.

Steve Arthur: Great. Thank you very much. I guess just looking at the Civil margins, looks like good progress this quarter coming in at around 17 percent.

I suspect you don't want to get into too much specifics in terms of where that should track for the year. Can you just give us some more color on the nature of the steps you're taking operationally to drive utilization to drive margins? And then over the longer term view, maybe three to five years, what kind of margin levels do you see as reasonable target for this part of the business?

Marc Parent: Well, I think I will start. Steve, thank you. The tactics and the strategies we're developing to implementing, to improve the margins (savilla) are really not different except for the process transformation plan that we're communicating today. And really involves just increasing the amount of utilization in our training center.

And that's really increasing the number of customers coming to train with us in our existing network of training centers and incrementally going to airlines and convincing them to either in part or in total to outsource their operations to us, which will further increase the level of activity.

And as we've always mentioned, the (coit) in the training center network, if we increase the utilization of the existing centers, clearly there's a disproportionate amount of that revenue that goes to the bottom line because you're absorbing more fixed costs.

Beyond that, the changes that we're announcing today I think are important because what they do is they put more distance between us and with our competitors. In terms of, first of all, the new products, which we've announced before, the 7000XR technology and simulator, which is being implemented in our plan now and will be over the next few months, which is allowing us to be able to be much more efficient than even we were before, which I think we were already efficient.

And that will translate into some extra value for us and our customers. How that tracks forward I think that maybe, Stephane, you want to pick that up?

Stephane Lefebvre: Steve, as we've announced this morning, the process-improvement project that we're undertaking will provide about CAD15 million to CAD20 million of savings on an annualized basis, once the process-improvement project is completed towards the second half of next fiscal year. And you can – the way to look at it, it will probably translate into a CAD0.03 to CAD0.04 additional EPS.

So of course a lot of that savings will make its way across all of our divisions, Civil and Defense, but a lot of it will go to the Civil business. So for us, clearly we see this as an element that will allow improving our margins over time.

Steve Arthur: I guess as a long-term view of objectives, in the past we've talked 20 percent-ish type ranges for the Civil business. Is that still a reasonable outlook for the longer term?

Stephane Lefebvre: I think so, Steve. If you look at – if you do the math, CAD0.03 to CAD0.04, once we're fully implemented over, CAD1 billion, CAD1.2 billion of revenue that we've had in the business last year. So I get to pretty much the same place as you do in the longer term.

Steve Arthur: Thanks. I will re-queue for some more questions. Thanks.

Operator: Our next question comes from the line of Cameron Doerksen with National Bank Financial. Please proceed with your question.

Cameron Doerksen: Yes, thanks. Good afternoon. I just wanted to come back on that issue with the margins and the process-improvement plan here, which presumably I guess is in part a response to a more competitive environment out there.

I guess I'm wondering what your thoughts are on whether we will actually see the savings show up in the bottom line or given the fact that maybe the full-flight simulator business has become a little more commoditized, will that ultimately just be given away in lower prices given what's going on in the competitive environment?

Marc Parent: I think that the – I'll start with Cameron. First of all, I will tell you this is not in response to what other people are doing. I'd like to say we play our own game and other people play theirs.

And I think that what we're doing is continuing to do what CAE has always done is continue to innovate, innovate our products and make sure that we continuously improve the way we do things. And in this particular case, the new 7000XR product that we developed allows us going forward, as we deliver more and more 7000XRs, to be able to produce our simulators, engineer, produce them in a more efficient manner, and that translates into the savings that we talked about.

And I think those savings we talked about, you heard what Stephane said, I would agree that even 3 percent to 4 percent – CAD0.03 to CAD0.04 incremental all else being equal. I think we – our assumption in that, I think you could take for granted that we're assuming a competitive environment that we see today in talking about that incremental margin. And I guess I think we will leave it at that.

Cameron Doerksen: OK. So it's not your view, though, that the full-flight simulator market has become more of a commodity market, and you do believe that CAE can still

differentiate itself with all the various product offerings that you have and the technology that you have.

Marc Parent: Absolutely. Absolutely. The simulator market is not a commodity market, and we are able to differentiate. And that's testified by the market share that we get and still being able to deliver, combined with the training business, 17 percent margin. I don't think that equates to a commodity market.

Cameron Doerksen: Very good. That's all from me. Thanks very much.

Operator: Our next question comes from the line of Turan Quettawala with Scotiabank. Please proceed with your question.

Turan Quettawala:Hi. Good afternoon. I guess I'm going to try one more question on this restructuring. Just is it fair to assume, then, this is going to come mainly from the Civil products business? Is that right?

Marc Parent: Not totally. The big impetus is in Civil, Turan, but it has effects on the military business as well because – I won't go through all the details of it, but here's one example of what this does. We carry – we produce a number of different types of simulators today by different type names that we provide, both in Civil and in military.

This 7000XR product and the way we engineering it allows us to transition to really have one product line, the 7000XR, which applies to the Civil business, which as you know has the bulk of the sales of simulators themselves, but that same simulator platform in great part is being used on military platforms, like for example the C-130J.

So you are going to get some of that benefit on the military business, obviously prorated the amount of simulators we do for the military. So you are getting in both cases.

Turan Quettawala:Got it, OK. But it's mainly products, obviously.

Marc Parent: Yes, it's products.

Turan Quettawala:OK. And then I guess why is it taking so long to get it done? Maybe it's a bit of a stupid question, but if you're just thinking of people, that can be done a lot quicker, right?

Marc Parent: This is not a because of a reduction in volume. The fact is, we have an increased volume going through our plants right now. Even though we reduced the amount of capital investment, we're still producing simulators for ourselves.

This is not a result of us dropping production rates for example like that. Our markets are very good.

So really the changes that you will see – first of all, we're not complete in changing all the processes that the 7000XRs allows us to do. Those will happen as we deliver more and more simulators with that product line.

There is a learning curve associated with that, for example. So you will see those process changes translate into the savings as we complete the – as we go for the next 12 months.

Turan Quettawala:OK. But I guess there was a reduction in the number of people, correct? Is that already done or ...

Marc Parent: No, I think that the 350 that we have announced going forward – we did have a restructuring that we quoted associated with people in the first quarter, but the 350 that are going forward, that's associated – that's going to happen related to the process changes we will make, that's going to happen probably towards the end of this year and into the probably early to mid part of next year. That's where the 12 months comes from.

Turan Quettawala:OK. That's helpful. Thank you very much.

Operator: Our next question comes from the line of Kevin Chiang with CIBC. Please proceed with your question.

Kevin Chiang: Hi. Thanks for taking my question. Maybe I will just turn to your return on capital employed number. It was down modestly I guess sequentially to CAD10.3 million.

When I look back historically, call it five or six of the last several years, Q1 has been your high point for the year. But given the strong start to utilization, given some of the restructuring, I'm just trying to get a sense of how you see this ROCE number trending through the year or if you think the previous trends make sense through FY16.

Stephane Lefebvre: This is Stephane. When we submitted our Q4 results, we said that we expect to see an improvement in our ROCE, and this will come from two different sources. We continue growing our business of course, and there's going to be less investment in CapEx, different development costs and so on.

We don't change our guidance. This is still what we see today. I think what you're referring to is you've seen quite a high increase in investment in non-cash working capital in this quarter. And it is the case (minute).

Every year in Q1, Q1 is a period where we have to release a lot of annual payments that go through our numbers in the first quarter. So we've invested about CAD113 million in non-cash working cap in Q1.

It is higher than our investment in Q1 last year. But quite frankly I think I said on the call last time, I do see still some investment in non-cash working cap being necessary for this year as we grow the business. But I don't think that we will be investing more in the first half of the year than our investment in non-cash working cap the first half of last year.

The timing is just such that a lot of payments went through in Q1 this fiscal year and not spread over Q1 and Q2 last year. Maybe just closing off on the ROCE itself, the fact that the Canadian dollar moves down, continues to moves down is a positive for us on the P&L side. But we also have to reval our balance sheet on a regular basis. So that plays – puts some pressure on the ROCE itself.

On the other hand, we continue burning down some of the hedges that we've put in place in the past. So the further down we go, we get to recognize to get revenue that's more beneficial hedging rate than we have in the past. So all in, understand that you see some pressure in the ROCE in Q1 and in the near term, but just to conclude, we don't change our guidance for improvement in ROCE this year.

Kevin Chiang: That's helpful. Maybe just a quick clarification point. On the CAD15 million to CAD20 million savings related to the restructuring, just trying to get a sense of how long it will take to realize that.

Is that effectively in the first year, starting from the second half of FY17 you would expect to start seeing those annual costs rolling through your P&L, or could we see that actually earlier as you progress through that restructuring?

Stephane Lefebvre: The CAD15 million to CAD20 million is an annualized number, Kevin. And I guess it will really ramp up as we – first of all, complete the overall program which will be done by mid – probably mid next week. And so we will see part of that in ...

Marc Parent: Mid next year.

Stephane Lefebvre: Sorry. Next year. And so we will see some of the benefit in FY17, not the entire CAD15 million, CAD20 million.

As we ramp up, transforming – adapting our new processes to different platforms it will ramp up. That's why we've got a range of CAD15 million to CAD20 million over time.

Kevin Chiang: That's it from me. Thank you.

Operator: Our next question comes from the line of Benoit Poirier with Desjardins Capital Markets. Please proceed with your question.

Benoit Poirier: Thank you very much. Good afternoon. Just to come back on the previous question about free cash, what should be the consumption or the usage in

working cap this year? You mentioned that it would improve versus last year but – and what would be the sustainable level in the longer term, Stephane?

Stephane Lefebvre: Well, couple of – two parts on your question. I think what we see, as I said to Kevin, we're not changing our guidance.

I think what we see, Benoit, is as the business continues growing and as there's in relative terms more, more revenue coming out of our service business than product, we have to invest in non-cash working cap. Every year as we continue growing, there will always be some level of investment in non-cash working cap.

More specifically on Q1 in this year, I think I've looked back at the amount of money we've invested in our non-cash working cap in the first half of last year, and I don't think that we will invest more than what we have in H1 of last year. I think you're familiar with the patterns. Usually Q1 we see large investment in non-cash working cap. Q2, a little bit of investment and then Q3, Q4 a reversal of non-cash working cap, and that's what I see as well for this year.

Benoit Poirier: Second question. If we look at the Healthcare margin, been down versus a year ago. Was just wondering if you could provide more color about the seasonality and maybe what we should be looking going forward.

Marc Parent: There is an element of seasonality in the business, Benoit. We will look at it very much relative to the volume of business, the business, the Healthcare business can get at around CAD24 million of top line. We would have expected relatively good margin in the first quarter.

One thing that I think I should mention that affected the results in Q1, and I don't think will affect the results going forward, is that we've changed the assembly line down in Sarasota from batch production to a one piece flow type of manufacturing process.

And I know that there's a number of products that we sold in Q1 and we're not – we just ran out of time to deliver the products to our customers as a result of



the disruption that we've seen in the assembly line down in Sarasota. So that will be – will reverse going forward.

Benoit Poirier: OK, Stephane. And moving that assembly line to a one piece flow, what should be the impact on the margin? I would assume it's positive as you grow the volume or ...

Stephane Lefebvre: It is positive. When (ken up) product – the gross margin that these products generate, the volume is really the biggest driver here.

Benoit Poirier: OK.

Stephane Lefebvre: So as we really sell some more and you've seen the impact it has had in the FY15, then you will see margins improving going forward.

Marc Parent: I would add, Benoit, there's a big reason why we changed this manufacturing process is to set us up for larger scale which is obviously – we're not satisfied with the – although we made good progress, we've increased our critical mass, clearly we have ambitions for a larger business.

Benoit Poirier: OK. Perfect. Thank you very much for the time. I will get back in the queue.

Operator: Our next question comes from the line of David Tyerman with Canaccord Genuity. Please proceed with your question.

David Tyerman: My first question's just going back to the 20 percent EBIT margin for Civil as a potential. Is that a full-year figure that you're talking about?

Stephane Lefebvre: This is what we believe the business can eventually get to as EBIT margin for going forward and, yes, this will be on an annualized basis.

David Tyerman: OK. So given your program, the process transformation plan, it sounds like 2018, FY18 would be the time frame that, that would be possible?

Stephane Lefebvre: Absolutely. I think you're right.

David Tyerman: OK.

Marc Parent: Well, it's Marc. Obviously with the market being robust, obviously, because what we talked about 19 percent before, we always talked about continuing the assumption of a robust commercial market, which we have today, and increasing – continually increasing levels of activity in the business aircraft market which has been increasing, albeit modestly.

David Tyerman: OK. Understood there. So just wanted to correlate something here then. So my calculations are that's maybe a 1 percent to 1.5 percent improvement in margin on Civil if you got all of it in Civil, and sounds like some of it goes to military.

So you did 16 percent, about – a little bit over 16 percent last year, so it sounds like you've got quite a bit of margin expansion beyond just this program over the next couple of years based on what you're seeing for your modeling. Is that a fair assessment? What would be the drivers?

Marc Parent: It hasn't changed except for this program, which you just mentioned. I think the rest mainly comes across as the same driver we talked about before, is growing the utilization or existing training network, continuing to grow share in the training market which is a bigger market and where – unlike the simulation products market where we have a 70 percent market share of selling simulators in actually delivering training, we have about 25 percent in a much larger market.

So clearly our focus is to try to grow our share in that market, and that's where if we're able to do that and throw more incremental revenue across those assets, that's where we see margin expansion which is what we've said in the last couple years.

David Tyerman: Exactly. OK. Thank you very much. Actually, just one – the extra cost on the transformation program, was it CAD19 million more on top of what you spent so far?

Stephane Lefebvre: It is, and that's a net-of-tax figure, so that compares to the CAD5.7 million that we quoted for Q1.

David Tyerman: OK. So CAD19 million more to go after that?

Stephane Lefebvre: Correct.

David Tyerman: Thank you.

Operator: Our next question comes from the line of Konark Gupta with Macquarie.  
Please proceed with your question.

Konark Gupta: Good morning and thanks for taking my question. Just wanted to clarify one thing before asking my question on the restructuring side, that CAD19 million pretax. What that amount is – sorry, it's after tax.

What's the amount before tax? What timeframe are we looking at in terms of realizing that? Is it evenly distributed over the next three, four quarters or it's back-end loaded?

Stephane Lefebvre: Look, it is an after-tax number. You've seen (attacks of) what we did is some of the restructuring efforts will be done in Montreal, in Canada, some outside of Canada, so we've been very specific on coming up with the exact precise tax impact. So that's for the first part of your question. CAD19 million is an after tax.

And then for the second part, well, as I think we said it, but the program will span over probably mid of next fiscal year. And so we expect most of the effort, the restructuring effort to be done in the end of this fiscal year and early FY17.

Konark Gupta: OK. That's great. Thanks. So my question is on the training-utilization side and the Civil-product side.

Given where the business jet market is today and what outlook we expect over the next couple of years, as you probably know some OEMs are very cautious heading into 2016, some are reducing production rates. So what impact or what outlook do you see for your simulation products and training network with respect to business jet?

Marc Parent: Well, I think business – in terms of the impact of business aircraft on the product market, essentially there is none because there is no real sales of

simulators for business aircraft. Really business aircraft operators trained in our network of simulators. So it's really we're talking about – it's all the impact is training.

And really what effects – what is the market driver for our business in training is not delivery of aircraft out of the OEMs. It's really the level of flying activity by a business aircraft operators around the world. So that's really what you're looking at to see our fortunes in that – in the business aircraft world.

I can tell you, right as we speak today, levels of activity we've seen them as higher as we expected. We expected modestly higher in relation to the higher level of business aircraft flying activity that we've seen.

It hasn't been uniform. I think there's, for example, less activity certainly that we've seen from operators in Russia as a result of geopolitical activities happening here which you might expect. But other than that, I think that we've been stable to growing in business jets.

Konark Gupta: Marc, just to that point, geographically, which geographic locations are you more exposed to business jet training, if Russia, China and Brazil are weak right now? Are they bulk of your training, business jet training business, or is it more like North America?

Marc Parent: Our two largest training centers are in Dallas, which is the largest training center of business aircraft in the world, and we're in New York and Morristown where we have a large training center there. So clearly we derive what I would say disproportionate level of business aircraft revenue and earnings from our network in the United States.

That is not to say we don't do well in Europe, based on our centers in the U.K. and in the Middle East. We do have activity in China as well. So I think the short answer is disproportionately the United States, and it's normal because where the bulk of the flying activity is.

Konark Gupta: Perfect. Thanks a lot for your answers. Thanks.

Operator: Our next question is a follow-up question from the line of Benoit Poirier with Desjardins Capital Markets. Please proceed with your question.

Benoit Poirier: Yes, thank you very much. At the AGM this morning, you disclosed the training opportunity mentioning that you have only 25 percent of the CAD3 billion market.

So I'm just wondering, Marc, going forward, what is the strategy on the Civil equipment? Obviously market share is very (I)ye). Do you foresee any opportunities to buy some simulator fleet from some carriers, or it's mostly going to be done through emerging markets that need more of a full solution?

Konark Gupta: Well, I think it will – look, I think the short answer is it will be a combination of both. Clearly, we're trying – as level of flying activity increases, based on revenue passenger kilometer flying by airlines grows, our business goes with that. That's number one.

We will seek to add simulators to support the growth of our joint venture partners. That's what we said. That's much higher, much more highly accretive than, for example, the simulators we put in the past where it was more speculative in terms of investment.

And we will as we are today and we've been successful for example recently companies like Japan Airlines to attempt to partner with airlines for them to outsource part or all of their training activity with us. And it doesn't necessarily mean that we will take on their assets.

If we decide to do it, it will be – it's because we feel that we had an accretive deal and would be good for CAE for longer term because they're long-term contracts. In the case of Japan Airlines, we didn't have to do that. That was not part of the deal. I think it will depend I guess is how I answer.

Benoit Poirier: On the commercial training given the economic uncertainty, have you started to see any weakness outside of North America in emerging markets and Europe?

Marc Parent: Not more than we've seen in the past. We've seen – we saw last year slow down in South America, and we saw – I guess we'd seen no recovery in Europe and I don't think we still see recovery in a large scale, although I would tell you activity has been better but that could be just seasonal right now.

So I don't – from our perspective, the macro environment that's affecting flying activity has not adversely affected us, and airlines are more profitable than they have been in a long time so that's good for us. So at the moment we don't see any level of further – any real change that's affecting – negatively affecting our business.

Benoit Poirier: OK. Thanks very much, Marc.

Andrew Arnovitz: Operator, we will now conclude the Q&A session with investors and financial analysts. I would note that I will be available to take calls after this conference call, should there be any remaining questions. We will now want to use the last 15 minutes or so to open the line to members of the media for question and answer.

Operator, if there are no more questions for today, we will conclude the call. I want to thank all participants for joining us on the call, earlier today during our annual general meeting, as well during this specific call related to the first quarter.

I would remind participants that a transcript of today's discussion can be found on CAE's Web site at [www.cae.com](http://www.cae.com). Thank you very much.

Operator: Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines.

**END**