Conference call: CAE INC. Q4 CONFERENCE CALL (Q&A only)
Time: 1:00 p.m. E.T.
Date: May 23, 2012

OPERATOR: The first question comes from the line of David Newman from Cormark Securities. Please proceed with your question.

DAVID NEWMAN: Good afternoon, gentlemen.

MARC PARENT (President and Chief Executive Officer, CAE Inc.): Hello, David.

DAVID NEWMAN: Just on the margin guidance or the margin guidance maybe you can give us, on the military side, obviously you had 300 cuts. I guess my question is: where are they coming from? Is it professional services, xwave or some of those areas? And does it imply that the margin guidance should also see commensurate pickup by about $25 million? And any guidance overall you might have on the military side. And then I'll switch over to the civil side.

MARC PARENT: I think maybe if I go to the essence of your question, I think the cuts are, you know, I think not… there's a lot in Europe, as you would imagine, because of what we're doing here. But it's spread across the business. I mean, in Canada we have some as well as obviously we have a lot of personnel here. There's about 90 here, mainly headquartered in Montreal. And maybe just go to the essence of your question, I think what I would tell you is that we expect probably about $8 million of annualized savings that come out of that. And if you look at when we're doing this, and there's going to be some disruption around this, so, you know, I think we'll get maybe three to four benefits this year out of that.

DAVID NEWMAN: And would any initial comments on margin profile that you might expect or is it just too much of a crystal ball at this point?

MARC PARENT: I think in terms of military margins, I think… we continue to expect the kind of outlook that we've seen between, you know, 15 and 16 per cent overall for the military business.

DAVID NEWMAN: Okay. And then on the civil side, you did 37 sim sales this year – a great year – and what's your expectation for next year, and what might that imply on the civil side? Probably more manufacturing, but looks like you're fairly consistent on the training side.

MARC PARENT: Well I think if you look at our products business, I mean, the market drivers for that is really, in large part, the delivery of aircraft coming out of the OEMs. So I mean, they've increased their production rates and they continue to do that, but of course it's a slow ramp up. So, you know, based on what I see, we're expecting again probably a high number, probably similar to what we guided for this year, about mid-30s. That would be my guess at this point. Early in the year.

DAVID NEWMAN: Okay. Perfect. And then on the margin side, can you see anything that will be plus or minus from what you did this year or going forward?

MARC PARENT: Well I think you looked at a margin for combined civil business. I think what we said before is that at the peak of the cycle, you know, in the business – and I talk before Oxford here – we were talking about the top of the cycle we would expect to be able to make in the region of about 22-per-cent EBIT, combined business. You saw what we're delivering. We're doing close to 21, so I think we're doing pretty well considering that business aircraft hasn't really ramped up fully. I mean, the small business jets and medium hasn't really recovered. So there's juice to be had from there.

I think if you look at it post-Oxford, you really, I think, need to adjust for, as we discussed in our call last week, to if you take Oxford business, about half of that business comes from our pilot-sourcing business, CAE Parc. And that's lower margins. I mean, great business, but lower margins, not capital intensive.

So I think if you look at it, although the transaction is very accretive to earnings, I think obviously it'll be dilutive to margins, you know, going forward because of the… mainly because of the contribution of Parc, and the fact that there's some synergies to be had to ramp up the performance of their training business to the same level of ours, which we're already started to do.

OPERATOR: Thank you. Our next question is from the line of Cameron Doerksen from National Bank. Please proceed with your question.

CAMERON DOERKSEN: Yes, thanks. Just want to go back to the military segment for a second. Specifically on the revenue, I mean, I appreciate that there's some difficulties in trying to predict the timing of certain contracts, but would it be your expectation that the military... combined military revenue would grow this year, and if so do you have any guidance you can provide on the magnitude of that growth?

MARC PARENT: I think I expect that, you know, based on what I see of the pipeline of opportunities on top of the… you know, the backlog that we have that we'll be able to continue growing this business. You know, I keep to my expectation of modest growth this year.

CAMERON DOERKSEN: Okay. Thank you.

OPERATOR: Thank you. Our next question is from the line of Turan Quettawala from Scotiabank. Please go ahead.

TURAN QUETTAWALA: Yes, hi, good afternoon. Just I guess on the military side as well just to follow up with the last question, what per cent of your sort of revenue growth expectations, Marc, is already sort of won in terms of contracts for fiscal ’13?

MARC PARENT: What… let me just… I’m not sure I understood your question. You cut out. I think you were saying how much is in backlog, is that what you meant?

TURAN QUETTAWALA: Yes.

MARC PARENT: Okay. Okay, got it, sir. I think at this moment we have approximately about 65 to 68 per cent, in that region, in backlog. If I look at the U.S. specifically we probably have approximately… no, I think we’ll keep it at about 65 to 68. That’s solid numbers.

TURAN QUETTAWALA: That’s great.

MARC PARENT: Backlog.

TURAN QUETTAWALA: Let me just… That’s great. Thank you. And I guess, if I may, one more, on the military backlog again, you know, if I look at the same products backlog I guess on the military side that’s down, but training services is up, and that’s been sort of the case for the last couple of quarters here. Is that sort of an ongoing change in behaviour do you think or is that just sort of temporary?

MARC PARENT: Well, I think we’ve talked about a while ago that, you know, we see the tendency for governments to outsource training and provide – and that’s good for us. There’s good growth of recurring training services. So the growth of, you know, backlog in training is a good story for us.

I think what I would say though it's hard to look at it in between quarters or even six months at a time because there's a lot of variability in terms of when we can book these. So, you know, I would expect that we're going to be able to ramp back up some product orders to get back into the proper mix there.

OPERATOR: Thank you. Our next question is from the line of Benoît Poirier from Desjardins Capital Markets. Please proceed with your question.

ETIENNE DUROCHER: Yes, good afternoon. This is Etienne Durocher on for Benoît. Just had a question on the competitive landscape. I was wondering, Marc, if you could provide your comments about the competitive landscape, if you expect any changes now that L-3 has acquired the civil business of Thales?

MARC PARENT: I think… well obviously if somebody… L-3 has bought Thales, it's inevitable it's going to change because it's a different owner. Having said that, you know, what it means for us… and we'll see, but clearly, I mean, the one thing I would tell you is we never rest on our laurels. We were dealing with a formidable company opponent to start with.

I mean, Thales is a great company and L-3's a great company, and I'm sure that they'll want to do well in their business.

But, you know, I think that we're confident in our ability to continue to succeed in the market. You know, that's all we do. We excel in what we do. We spend about 10 per cent of our revenue every year to make sure that our products and services in this business are really at top notch. We take very, very good care of our customers, both in the quality products, the services we provide, the customer support.

And if you look the bandwidth of our capability, both from a product services, pilot sourcing, ab-initio flight school, and the geographical bandwidth that we have, I think we can certainly be the formidable opponent that we have been to anybody coming in.

But, you know, we'll be smart, but again, we're not in to giving up our share of the market.

ETIENNE DUROCHER: Thank you.

OPERATOR: Thank you. Our next question is from the line of David Tyerman from Canaccord Genuity. Please go ahead.

DAVID TYERMAN: Yes, good afternoon. Just a follow-up question on the military side. So it looks like your SPM backlog is the lowest it's been in I think three years. You've got pretty good TS(ph) and backlog, but that's very long dated. And we also have problems in Europe and problems in the U.S. I guess I'm wondering what is the risk here that you, instead of getting actual modest growth, that you end up with modest declines? And I'm thinking particularly on the equipment side because your backlog is down and perhaps contracting, et cetera, is delayed as usual it seems these days.

MARC PARENT: Well, I think what I'll tell you – you saw the answer that I gave there, we have about 65, 68 per cent in backlog now for the year. I mean, last year at approximately the same time we probably had about 70 if I recall. A bit lower overall. But again if I'm telling you I think that we'll get modest growth is because, you know, I have a pretty good visibility on the pipeline of opportunities that we're bidding near term, longer term and making some allowance for, you know, what can be delayed.

In the end there's no doubt. As is every year we have to win orders to continue to progress. Do I think we will win them? Yes, I'm pretty confident that we will, and I feel strongly that we'll be able to continue to grow this year modestly.

DAVID TYERMAN: Okay, that's helpful. Thank you.

OPERATOR: Thank you. Our next question is from the line of Ron Epstein from Bank of America. Please go ahead.

ELIZABETH: Hi. Good afternoon. It's actually Elizabeth in for Ron.

MARC PARENT: Hello, Elizabeth.

ELIZABETH: Hello. For the $25 million for the one-time expenses that are expected in the first half of the year, how should we think about how they'll be weighted across the first two quarters? Will it be heavier in the first quarter?

MARC PARENT: Stéphane, you want to take that one?

STÉPHANE LEFEBVRE (Vice President, Finance and Chief Financial Officer, CAE Inc.): Yes. I think it will be the case. It will span over… well, as Marc has mentioned I think in his remarks, a lot of the people are being advised today and so I expect that most of the $25 million would be incurred in the first quarter. There will be some more in the second quarter, but it will really be in the first of the year, mainly in the first quarter. The vast majority of it will be in the first quarter.

ELIZABETH: Okay. And can I ask one more question on the new core markets? How should we think about the margins progressing throughout the year? I mean, if it's profitable on the average for the year, but how should we think about it progressing through the quarters?

MARC PARENT: We haven't really provided any outlook on that yet, Elizabeth. And the reason we don't, frankly is because we are continuing to invest in this business because we don't want to stop at the level of revenue that we're going to target for this year, you know, in the

$120 million range. I mean, my view is that we'll be profitable for sure, but we're going to continue to invest in R&D and SG&A to support the creation of a stronger business. So I'm not ready to be able to really, you know, provide, you know, very precise profitability, quarter by quarter, at this point.

ELIZABETH: Okay. Thank you.

OPERATOR: Thank you. Our next question comes from the line of Scott Rattee from Stonecap Securities. Please proceed with your question.

SCOTT RATTEE: Great. Thank you. I just wanted to sort of check on the full flight simulator side. Could you give us how many deliveries you had this year, both sort of internal and external? And then also maybe just some colour on what sort of manufacturing capacity you do have available? Thanks.

MARC PARENT: We delivered 34 simulators this year, and 28 were external, six internal, and what I would tell you is we have lots of capacity. I mean, there's no… I would tell you I've done a lot of operation in my life. Capacity is not an issue.

SCOTT RATTEE: Okay. That's great. Thank you.

OPERATOR: Thank you. Our next question is from the line of Anthony Scilipoti from Veritas Investment Research. Please go ahead with your question.

ANTHONY SCILIPOTI: Hi. Thanks very much. I'm just looking at the cash flow statement, and I wanted to understand one difference looking specifically on the investing side in the joint… in the line item marked joint ventures, and it's moved from a negative 1.9 to a negative 28-7.6. And I know that reflects on note 4, but maybe you could give us some colour on what is happening in these investments and how we're to interpret them from the standpoint of the rest of your business?

STÉPHANE LEFEBVRE: Sure. Well these are, as you know, this is… we've created a number of joint ventures in this last fiscal year, more than the year before, and some are quite sizeable in nature. So that represents our share of the equity investment in those joint ventures.

ANTHONY SCILIPOTI: It could also be for the transfer of assets for flight simulators or...?

STÉPHANE LEFEBVRE: Well we actually… it's really our equity investment in these ventures. And we subscribe to some equity. Our partner does as well. And this is the way we fund all of the investment that have to be done within the joint venture, including purchasing some simulators from us, obviously.

ANTHONY SCILIPOTI: I see. Okay. That's good. Thanks.

OPERATOR: Thank you. We have a follow-up question from David Newman from Cormark Securities. Please go ahead.

DAVID NEWMAN: Just a quick follow-up, guys. Just on your METI acquisition, I think one of the things you described in Florida was a move into the clinical setting and then additionally partnering with OEMs on the ultrasound devices. You want to give us a bit of colour on how that's proceeding?

MARC PARENT: We don't have anything we can announce at this moment, but I think the penetration of our ultrasound devices is going very well, and then it's probably the highest growth sector at the moment, and we're very optimistic about possibly going forward. And yes, we are talking to OEMs, and I'm optimistic that we'll be able to do some things that will be announced, you know, in the future. Nothing now. But I'm optimistic about certainly that prospect for sure, David.

DAVID NEWMAN: And the clinical setting, any uptake there?

MARC PARENT: Well I think, you know, as we said, the majority of our sales so far in the medical business is still really educational institutions because that's where the market is. Some very… I think some movement in the clinical side, mainly on nursing I would tell you.

DAVID NEWMAN: Right.

MARC PARENT: That's a strong market. But the bulk of it, no, mainly because… I mean, it's a lot… that's I think a longer-term process, and we’re not counting on it for the growth of business. But certainly would be… when and if it happens, it’ll be quite a big opportunity for us.

DAVID NEWMAN: Very good. Thank you.

OPERATOR: Thank you. Our next question is a follow-up from David Tyerman with Canaccord Genuity. Please go ahead.

DAVID TYERMAN: Yes, a quick question on the training and services civil. That business used to be quite seasonal with… in margins, with high margins in Q1 and Q4 I guess revolving around the pilot cycle and airlines. It was actually down, the margins were actually down in Q4 this year compared to the previous Q – not very much, but just a little. I was wondering, has the seasonality changed or was there something… I think there was a mention of a hit on non-cash working capital from FX. Just wondering is there seasonality like there used to be or has this changed, and what happened in Q4 of fiscal ’12?

MARC PARENT: No, there’s no change in the seasonality. I think you still see, you know, when pilots are flying a lot they’re not training a lot. So that you see...

DAVID TYERMAN: Yes.

MARC PARENT: I think that… maybe, I think, Stéphane, do you want to comment on any specific items that might have occurred there? I’m not aware of it.

STÉPHANE LEFEBVRE: No. I mean, the seasonality hasn't changed. The only thing in that I will mention that may explain the reduction in margin is during the fourth quarter we're resized parts of our business, as well as we've had to incur some… a lot of costs during the due diligence of the Oxford Aviation acquisition.

DAVID TYERMAN: Okay.

STÉPHANE LEFEBVRE: Okay?

DAVID TYERMAN: Okay. Yes, that might explain it. So I guess I just need to watch. And just two quick things. For fiscal '13 any thoughts on tax rate and capital expenditures for the year?

STÉPHANE LEFEBVRE: I believe the tax rate, we finished the year, well the quarter was at 26 per cent. There was nothing really very, very unusual with it. But it really depends on where the business is coming from as you know very well. I kind of took the fiscal year '12 and normalized for a few ups and downs in the quarter and the year, and I get to 27.5, 28 per cent. So I said a few times, I use 28 per cent for predicting fiscal '13.

OPERATOR: Thank you. Our next question is also a follow up from Benoît Poirier from Desjardins Capital Markets. Please go ahead.

ETIENNE DUROCHER: Yes, thank you. Just, if you could provide your capex guidance for fiscal '13? And also what amount… how much of that will be related to the renewal of the fleet, the simulator fleet at Oxford?

STÉPHANE LEFEBVRE: Well, we spent $165 million of capex in fiscal ’12. As you know, we’re really, at this point in time, going through the exercise of looking at each of the individual assets that we purchased through Oxford, and really we’re looking at two things. Number one is what is the actual level of investment that may be required on certain assets in the portfolio? And number two, how can we use some of those assets, potentially redeploy them, and get some savings from what we initially anticipated? We haven’t completed the exercise. I think we’ll be in a better position to provide some more guidance at the end of the Q4… Q1 results.

The only thing I would say though is obviously I would not expect the capex to be lower than the level that we spent in fiscal year ’12. We may have to spend a little bit more on relative terms for the assets we purchased at Oxford, but I don’t see a lot of additional… the capex being lower than when we had this year.

MARC PARENT: Yes, maybe to add just a little bit, so we’ll update you at the next call for sure when we’ve done the exercise, as Stéphane’s talking about. I mean… and the one thing I will precise is that the capex that we do put in our civil business these days is very targeted towards individual opportunities that give us growth.

And we’ve been focusing a lot on emerging markets. So that will continue. I mean, as we see the opportunities either to establish a joint venture with an anchor partner, I mean that's what we will do. And then as Stéphane said, we'll look at how could we optimize the assets that we've acquired with Oxford? I mean, we had a very good view of what we needed to do there from the due diligence exercise. But now we're refining and seeing well okay, well let's… how do we, you know, mix and match, you know, to optimize the capex and the growth of the business? So more on that next call.

OPERATOR: Thank you. Our next question is also a follow up, this one from Anthony Scilipoti from Veritas Investment Research. Please go ahead.

ANTHONY SCILIPOTI: Thanks. Guys, just looking at note 9 under other assets, I'm just noticing the balance for long-term receivables going up quite a bit. Maybe you could just give us some colour on what that business relates to and what the collection terms are on that... would... might be, too, et cetera?

STÉPHANE LEFEBVRE: It's actually, Anthony, it's actually… we purchased in Q4 the remaining shareholding that we didn't own before in a financing vehicle that we put in place many years ago called Simcap(ph). And that business had some leasing arrangements in place, so that's what explains the increase in the long-term receivable. It's actually the financing for a couple of assets that we purchased through the rest of the shares that we bought from Simcap.

ANTHONY SCILIPOTI: Simcap. That would have been financing for a customer to buy full flight simulators? I'm sorry, I don't recall exactly.

STÉPHANE LEFEBVRE: No. It was, yes, in this case there are two simulators that were actually financed to Simcap for one of our joint ventures.

MARC PARENT: Yes, this business, Anthony, maybe Stéphane, you can provide more colour, but we put together this vehicle at the time of the crisis in about 2002, and it was… We put it together at the time, you know, if you recall, of course, there was concerns about liquidity at that time, financing of airlines. So we had put it together working with some partners in the Quebec government, amongst others, and with EDC. And finally, as it all played out, we didn't have as much need to use that… the vehicle, so as Stéphane says, we bought out the remaining as partners now.

ANTHONY SCILIPOTI: And so it's old to you basically. That's why it's on your balance sheet. Okay.

MARC PARENT: Yes.

ANDREW ARNOVITZ (Vice President, Investor Relations, CAE Inc.): Okay, Operator, we'd like to have some time for members of the media. So I would thank institutional investors and analysts for their participation on the call. Operator, we'll now open the lines to members of the media.

OPERATOR: Thank you. Members of the press and media, if you'd like to register for a question at this time, please press the 1 followed by the 4.

Our first question comes from the line of Ross Marowits from the Canadian Press. Please go ahead.

ROSS MAROWITS: Yes, hi. I'm wondering if you could provide a little bit more details about the job reductions. Where in Europe are they located?

MARC PARENT: Germany mainly, but…

ROSS MAROWITS: Germany?

MARC PARENT: Mainly Germany.

ROSS MAROWITS: Okay. And you said I think 90 in Canada, mostly in Montreal?

MARC PARENT: Correct, yes.

ROSS MAROWITS: Is that all 90 in Montreal or were there other cities that would be affected?

MARC PARENT: No, no. It's Quebec. It's Montreal, and I'd preface that, Ross, by… you know, in the past year we've actually added about 250 employees in Quebec, and since 2005 we've raised the level of employment in Montreal by 27 per cent. But just at this moment in time where we have to really realign our business in defence, in particular, which causes some overhead reductions elsewhere. That's where the 90 are coming from.

ROSS MAROWITS: And what type of jobs are these?

MARC PARENT: It's across the patch really. I mean, let me just get a bit more detailed here. It's general, administrative jobs, overhead jobs, support jobs. I think those kinds of levels. Not much engineering, for example. In fact, I don't think there's any engineering.

ROSS MAROWITS: Okay. And this would be the biggest cut that you've made since I think 2009?

MARC PARENT: That's affirmative, yes.

ROSS MAROWITS: Okay. And lastly, you talk about that you're trying to refocus the business a bit. But you're cutting. So how are you refocusing? Is there growth somewhere else offsetting this or...?

MARC PARENT: Yes. If you look at Asia and the emerging markets, what you find is that they're… well, first of all, we already saw that they're re-fleeting in civil. They're building up their aviation business because of, you know, people wanting to fly in those markets.

On the military side, contrary to what we see in Europe, for example, there are countries in Asia, India, and the Middle East that are increasing their defence budgets significantly. And there's where the opportunities are. And if you look, we seized and we've been successful on capitalizing on those. If you look at… we signed $170 million contract in Brunei, for example, in the fourth quarter. We also signed a tank simulation centre in Malaysia.

So really it's no different than the rest… you know, what we usually do. The business follows our customers. We have half of our employees today, 8,000… close to half of our employees that are outside of Canada. I mean, Montreal remains clearly the headquarters and the technological... you know, where we keep the main part of our technology and R&D, but, you know, inevitably when we refocus the business, some jobs have to go to support customers locally.

ROSS MAROWITS: But are you increasing employment in those areas in Asia to support Asian and Middle Eastern growth?

MARC PARENT: Well, what I would tell you is maybe not in the immediate term, but yes. Overall, yes. What you'll find is I have no doubt that when we look at CAE next year, CAE will have more people, and likely it'll be more people over there rather than here. Having said that, we will continue to increase here because, as I said, you know, the bigger we get the more simulators we sell, the more products we do, the more R&D you need to do, the more support that you need from all the people at headquarters here in Montreal, so I would expect us to grow there. But at this point in time, yes, we have to adapt.

ROSS MAROWITS: Sure. And one other thing. Do you expect to have to make any other adjustments in workforce if the U.S., for example, were to cut its defence budget more?

MARC PARENT: You know, nobody knows the answer to that question. I mean, the U.S. right now is, you know, going through their budget process. I think the spectre is out there of this, what they call budget sequestration, if they can't reach an agreement. And nobody knows what the answer is if that happens. Of course, I don't think it'll happen, but, you know, that's just me saying that.

I think what I would tell you is we adapt our business depending on how many orders we get. And that's not going to change.

Do I feel that we'll be able… that the U.S. will go down and will affect us significantly? I would tell you the answer is I don't think so. We just had a record year in the difficult environment that we just went through and are still going through. I mean, it's pretty hard to pick when you'll get the orders, but, you know, we had a record order intake in the U.S. this year, thanks to great work by our U.S. team. And I would expect that to continue in a difficult environment.

Remember that what we do, simulation-based training, is… helps... is a help when you're trying to save money. So I think we… although timing is always difficult to predict, we feel good about the business we're in.

ROSS MAROWITS: Thank you.

OPERATOR: Thank you. I'm showing that there are no further questions from the phone lines at this time.

ANDREW ARNOVITZ: Operator, we'd like to thank investors, analysts, the members of the media and the press for their time this afternoon for joining us on the call. I'd like to remind everyone that a transcript of the conference call can be found on CAE's website at CAE.com. Thank you very much and have a good afternoon.

OPERATOR: Thank you. Ladies and gentlemen, that does conclude the conference call for today. We thank you all for your participation, and we ask that you please disconnect your line. Thank you everyone and have a good day.

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