

CAE Inc.

# Growth continues across segments, defense remains a show me story

Reiterate Rating: NEUTRAL | PO: 37.00 CAD | Price: 31.76 CAD

## Global air travel recovery continues to lift Civil segment

CAE's civil business momentum continued with 1Q24 revenue up 13% Y/Y, and utilization rates at 78% vs. 71% in 1Q23, even with the expanded footprint. We expect the trend to continue given air travel demand remains strong across the US & EMEA, and is rapidly recovering in Asia. As we noted in [our June Airline Traffic Tracker](#), total market passenger air travel (RPKs) was only 5.4% below June 2019 pre-pandemic levels. We anticipate further training center revenue tailwinds on strong demand, the newly opened Las Vegas training center, and the facility in Athens, Greece opening by the end of FY2024.

## Significant defense growth, waiting for margin inflection

Defense & Security revenue grew 14% Y/Y, while adj. operating margins remain depressed at 4.8%. CAE's defense portfolio still skews towards lower margins contracts. In the near term we see margin improvement in FY2024 on new defense wins, but the more meaningful contract mix shift remains to be seen until FY2025. Notably CAE was selected for the Canadian Future Aircrew Training Program, a multi-decade program estimated to be valued at \$2bn.

## Healthcare, self-funding growth

Healthcare grew 7% Y/Y, on increased patient simulator sales and centre management solutions from CAE's LearningSpace platform. At the Paris Air Show ([see our report](#)) management noted that they are not investing any new capital into the segment and that the business self-funds. The business does occupy approximately \$240mn of capital and CAE sees opportunities to extract additional value organically.

## Maintain Neutral, increase PO to \$37 CAD, \$29 USD

Our PO of C\$37 (up from \$33) is derived from a relative 1.5x P/FCF (unchanged) multiple on CY24E estimates. In our view, a multiple above the historical average fairly factors in CAE's actions to capture market share, the scarcity premium for a pure play on aircraft simulators, new defense wins, and balances the current underperforming margin profile in Defense. In USD our PO of \$29 is derived by applying an FX rate of 1.3 to our CAD PO.

Estimates (Mar) (C\$)	2022A	2023A	2024E	2025E	2026E
EPS	0.84	0.88	1.25	1.45	1.75
GAAP EPS	0.45	0.70	1.12	1.45	1.75
EPS Change (YoY)	78.7%	4.8%	42.0%	16.0%	20.7%
Consensus EPS (Bloomberg)			1.18	1.56	NA
DPS	0	0	0	0	0
EPS (CAE - US\$)	0.67	0.67	0.93	1.08	1.30
DPS (CAE - US\$)	0	0	0	0	0
<b>Valuation (Mar)</b>					
P/E	37.8x	36.1x	25.4x	21.9x	18.1x
GAAP P/E	70.6x	45.4x	28.4x	21.9x	18.1x
Dividend Yield	0%	0%	0%	0%	0%
EV / EBITDA*	19.7x	15.4x	12.1x	10.8x	10.0x
Free Cash Flow Yield*	1.6%	1.5%	3.0%	5.0%	6.4%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 5.

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15 August 2023

### Equity

#### Key Changes

(C\$)	Previous	Current
Price Obj.	33.00	37.00
2024E Rev (m)	4353.8	4613.2
2025E Rev (m)	4648.9	5037.3
2026E Rev (m)	5007.4	5437.9
2024E EPS	1.15	1.25
2026E EPS	1.70	1.75

**Ronald J. Epstein**

Research Analyst  
BofAS  
[r.epstein@bofa.com](mailto:r.epstein@bofa.com)

**Mariana Perez Mora**

Research Analyst  
BofAS  
[mariana.perez mora@bofa.com](mailto:mariana.perez mora@bofa.com)

**Jordan Lyonnais**

Research Analyst  
BofAS  
[jordan.lyonnais@bofa.com](mailto:jordan.lyonnais@bofa.com)

**Andre Madrid**

Research Analyst  
BofAS  
[andre.madrid@bofa.com](mailto:andre.madrid@bofa.com)

**Samantha Stiroh**

Research Analyst  
BofAS  
[samantha.stiroh@bofa.com](mailto:samantha.stiroh@bofa.com)

### Stock Data

Price (TOR / NYS)	31.76 CAD / 23.59 USD
Price Objective	37.00 CAD / 29.00 USD
Date Established	15-Aug-2023 / 15-Aug-2023
Investment Opinion	B-2-9 / C-2-9
52-Week Range	20.89 CAD - 32.68 CAD
Market Value (mn)	9395 CAD
Average Daily Value	19.72 CAD
Shares Outstanding (mn)	295.8 / 295.8
BofA Ticker / Exchange	YCAE / TOR
BofA Ticker / Exchange	CAE / NYS
Bloomberg / Reuters	CAE CN / CAE.TO
ROE (2024E)	8.5%
Net Dbt to Eqty (Mar-2023A)	66.1%
ESGMeter <sup>TM</sup>	Medium

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

# iQprofile<sup>SM</sup> CAE Inc.

## iQmethod<sup>SM</sup> – Bus Performance\*

(C\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	3.6%	4.6%	6.0%	7.1%	7.8%
Return on Equity	7.2%	6.4%	8.5%	9.1%	10.0%
Operating Margin	8.4%	11.3%	14.2%	15.7%	16.8%
Free Cash Flow	146	140	283	473	598

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(C\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.6x	1.5x	1.5x	1.8x	1.5x
Asset Replacement Ratio	0.9x	0.8x	0.8x	1.0x	0.8x
Tax Rate	2.3%	21.7%	22.0%	22.0%	22.0%
Net Debt-to-Equity Ratio	66.1%	66.1%	56.2%	42.4%	28.2%
Interest Cover	2.2x	2.7x	3.5x	4.4x	5.2x

## Income Statement Data (Mar)

(C\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	3,371	4,203	4,613	5,037	5,438
% Change	13.1%	24.7%	9.8%	9.2%	8.0%
Gross Profit	956	1,166	1,292	1,410	1,523
% Change	24.9%	22.1%	10.8%	9.2%	8.0%
EBITDA	637	814	1,038	1,161	1,249
% Change	18.0%	27.9%	27.6%	11.8%	7.6%
Net Interest & Other Income	(131)	(178)	(187)	(180)	(175)
<b>Net Income (Adjusted)</b>	<b>262</b>	<b>279</b>	<b>401</b>	<b>468</b>	<b>565</b>
<b>% Change</b>	<b>105.7%</b>	<b>6.8%</b>	<b>43.5%</b>	<b>16.7%</b>	<b>20.8%</b>

## Free Cash Flow Data (Mar)

(C\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	150	232	365	477	575
Depreciation & Amortization	311	342	384	370	337
Change in Working Capital	23	(115)	(113)	(21)	(42)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(65)	(51)	(30)	0	0
Capital Expenditure	(272)	(269)	(323)	(353)	(272)
<b>Free Cash Flow</b>	<b>146</b>	<b>140</b>	<b>283</b>	<b>473</b>	<b>598</b>
<b>% Change</b>	<b>-43.6%</b>	<b>-4.4%</b>	<b>102.9%</b>	<b>66.9%</b>	<b>26.5%</b>

## Balance Sheet Data (Mar)

(C\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	346	218	402	775	1,273
Trade Receivables	557	616	676	759	849
Other Current Assets	1,246	1,402	1,539	1,657	1,776
Property, Plant & Equipment	2,129	2,387	2,335	2,318	2,253
Other Non-Current Assets	5,301	5,814	5,714	5,714	5,714
<b>Total Assets</b>	<b>9,579</b>	<b>10,437</b>	<b>10,667</b>	<b>11,223</b>	<b>11,866</b>
Short-Term Debt	242	215	208	208	208
Other Current Liabilities	1,849	2,032	2,159	2,338	2,506
Long-Term Debt	2,804	3,036	2,938	2,838	2,738
Other Non-Current Liabilities	597	565	484	484	484
<b>Total Liabilities</b>	<b>5,492</b>	<b>5,848</b>	<b>5,788</b>	<b>5,868</b>	<b>5,936</b>
<b>Total Equity</b>	<b>4,087</b>	<b>4,589</b>	<b>4,879</b>	<b>5,355</b>	<b>5,931</b>
<b>Total Equity &amp; Liabilities</b>	<b>9,579</b>	<b>10,437</b>	<b>10,667</b>	<b>11,223</b>	<b>11,866</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 5.

## Company Sector

Aerospace

## Company Description

CAE provides simulation and modeling technologies and integrated training services to the civil aviation and military industries. In FY2020, about 42% of revenues were from simulation products and about 58% of revenue came from training and services. Although headquartered in Montreal, Canada, CAE has an unmatched global training footprint with 160 sites and training locations in over 35 countries, 135,000 pilots trained per year, and about 10,000 employees.

## Investment Rationale

We positively view CAE's recent actions to gain market share and expect the company should be a beneficiary of the global recovery in commercial traffic and the pilot shortage. Demand for pilots and crew trainings should recover in line with traffic vol. CAE flexible training options could become more attractive for the financially challenged airline customers. However, we are more cautious on the integration of the recent LHX business.

## Stock Data

Average Daily Volume	836,356
Shares / Common - Dual Listed	1.00

## Quarterly Earnings Estimates

	2023	2024
Q1	0.06A	0.24A
Q2	0.19A	0.26E
Q3	0.28A	0.34E
Q4	0.35A	0.41E

## Key Changes

(US\$)	Previous	Current
Price Obj.	25.76	29.00
2024E EPS	0.85	0.93
2026E EPS	1.26	1.30

## Civil expansion set to gain from increasing pilot demand

CAE's civil business expansion efforts continue with the recently opened Las Vegas facility, with three more planned. New training locations expected to open from FY2024-2025 include Georgia, Greece, and Austria. We anticipate CapEx as a percentage of sales to remain elevated at 7% (from 6.4%) for the next two years to fund the investment in the new facilities. We view the investments as a positive in the long term due to increased demand for pilot driven by travel demand and the large wave of pilot retirements coming. The GAO estimates 32% of all US Airline Transport Pilot (ATP) certificate holders will reach the mandatory pilot retirement age by 2032. CAE estimates 284,000 new pilots are needed over the next 10 years.

## Defense business wins

CAE's defense business adjusted backlog grew to \$5.4bn and \$8.8bn in outstanding bids and proposals. Management is confident in the programs they've submitted bids for and expect the momentum in the defense segment's turnaround to continue. In the quarter CAE Defense & Security was awarded \$328mn in new orders, while unfunded contracts stood at \$779mn. Notable wins include the 12-year Flight School Training Support Services for the U.S. army providing full-flight simulators for the CH-47F and UH-60M and winning the recompetes for the US Air Force Introductory Flight Training program, which was extended through 2033. CAE anticipates reaching a 50/50 split of low and high margin defense business by FY2025 with long term operating margins in the low teens.

## New financing, cash priorities focused on organic growth

On June 12<sup>th</sup>, CAE closed on \$400mn of 5.541% Senior Secured Notes due June 12<sup>th</sup>, 2028. The proceeds from the offering will be used to repay existing debt. CAE's capital allocation priorities remain focused on organic internal investments, reducing debt level to ~3x net-debt-to-adjusted-by the middle of FY2024, and then participating in dividends or share buybacks. At the Paris Air Show, management noted there are no plans for M&A in the near term.

## Raising EPS ests. on high demand & margin performance

We increase our FY2024 Adj. EPS estimates on the strong demand environment for simulators and training services, as well as the defense margin improvement. 2024: \$1.25 (vs. prior \$1.15), 2025: \$1.45 (vs. prior \$1.45), 2026: \$1.75 (vs. prior \$1.70), 2027: \$2.05 (vs. prior \$2.00).



## Price objective basis & risk

### CAE Inc. (YCAE / CAE)

Our PO of C\$37 is derived from a relative 1.5x P/FCF multiple on CY24E estimates. In our view, a multiple above historical average fairly factors in CAE's actions to capture market share, the scarcity premium for a pure play on aircraft simulators, new defense wins, and balances the potential for the aerospace recovery to be further delayed. In USD our PO of \$28.72 is derived by applying an FX rate of 1.3 to our CAD PO.

Downside risks to our PO: If there is another downturn in commercial aviation and pressures seen in the economy worsen, earnings could fare worse than our projections and the stock could underperform. If margins fare worse than we are expecting, there could also be downside to our valuation. M&A risk includes additional findings from the LHX acquisition.

Upside risks to our PO: sales and margins within civil, military and new core markets could exceed our expectations (if the aviation recovery is faster than we expect), and defense multiples could exceed their previous market multiple.

## Analyst Certification

I, Ronald J. Epstein, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### US - Aerospace and Defense Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	AerCap Holdings N.V.	AER	AER US	Ronald J. Epstein
	Air Lease Corporation	AL	AL US	Ronald J. Epstein
	Boeing	BA	BA US	Ronald J. Epstein
	BWX Technologies, Inc.	BWXT	BWXT US	Ronald J. Epstein
	CACI International	CACI	CACI US	Mariana Perez Mora
	Cadre Holdings Inc	CDRE	CDRE US	Ronald J. Epstein
	Crane Co.	CR	CR US	Ronald J. Epstein
	Embraer	ERJ	ERJ US	Ronald J. Epstein
	General Dynamics	GD	GD US	Ronald J. Epstein
	Howmet Aerospace Inc.	HWM	HWM US	Ronald J. Epstein
	KBR	KBR	KBR US	Mariana Perez Mora
	Leidos Holdings	LDOS	LDOS US	Mariana Perez Mora
	Northrop Grumman	NOC	NOC US	Ronald J. Epstein
	Palantir Technologies	PLTR	PLTR US	Mariana Perez Mora
	Parsons Corporation	PSN	PSN US	Mariana Perez Mora
	Rocket Lab	RKLB	RKLB US	Ronald J. Epstein
	Teledyne Technologies Inc.	TDY	TDY US	Ronald J. Epstein
	TransDigm Group Inc.	TDG	TDG US	Ronald J. Epstein
<b>NEUTRAL</b>				
	Albany International	AIN	AIN US	Ronald J. Epstein
	Booz Allen Hamilton	BAH	BAH US	Ronald J. Epstein
	CAE Inc.	YCAE	CAE CN	Ronald J. Epstein
	CAE Inc.	CAE	CAE US	Ronald J. Epstein
	Garmin	GRMN	GRMN US	Ronald J. Epstein
	HEICO Corporation	HEI	HEI US	Ronald J. Epstein
	Hexcel Corporation	HXL	HXL US	Ronald J. Epstein
	L3Harris	LHX	LHX US	Ronald J. Epstein
	Lockheed Martin	LMT	LMT US	Ronald J. Epstein
	Raytheon Tech	RTX	RTX US	Ronald J. Epstein
	Textron	TXT	TXT US	Ronald J. Epstein

**US - Aerospace and Defense Coverage Cluster**

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>UNDERPERFORM</b>	Astra Space Inc.	ASTR	ASTR US	Ronald J. Epstein
	Bombardier	BDRBF	BDRBF US	Ronald J. Epstein
	Bombardier Inc.	YBBD B	BBD/B CN	Ronald J. Epstein
	Huntington Ingalls Industries	HII	HII US	Ronald J. Epstein
	RBC Bearings Inc	RBC	RBC US	Ronald J. Epstein
	Spire Global inc	SPIR	SPIR US	Ronald J. Epstein
	Spirit AeroSys-A	SPR	SPR US	Ronald J. Epstein
	Terran Orbital Corporation	LLAP	LLAP US	Ronald J. Epstein
	Triumph Group	TGI	TGI US	Ronald J. Epstein
	Virgin Galactic Holdings	SPCE	SPCE US	Ronald J. Epstein

**iQmethod<sup>SM</sup> Measures Definitions****Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

**Quality of Earnings**

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

**Valuation Toolkit**

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

**Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

**Numerator**

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

**Numerator**

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization

Shareholders' Equity

Sales

N/A

N/A

**Denominator**

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

**Denominator**

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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# Disclosures

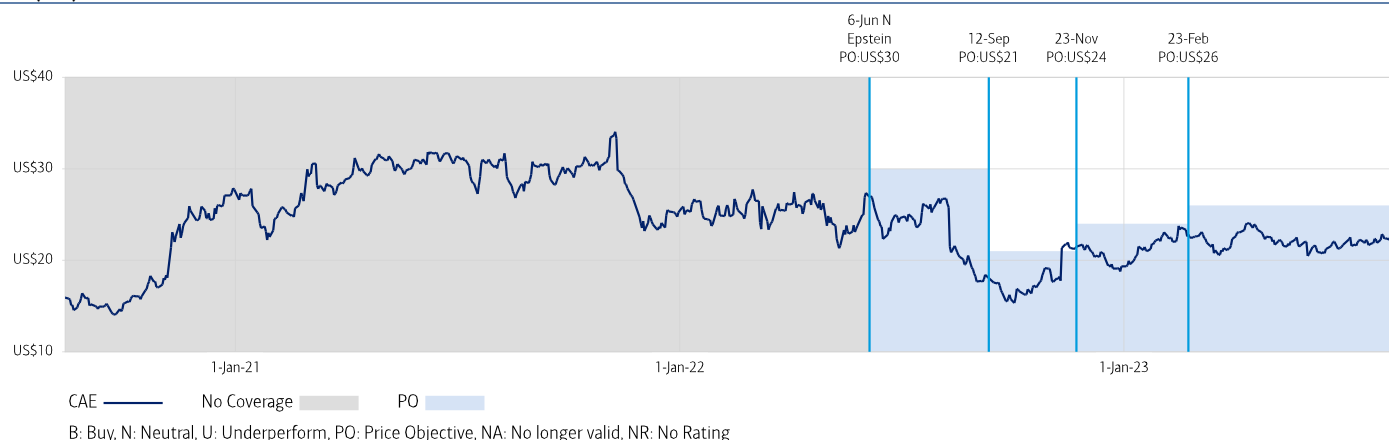
## Important Disclosures

### CAE Inc. (YCAE) Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### CAE Inc. (CAE) Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### Equity Investment Rating Distribution: Aerospace/Defense Electronics Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	25	50.00%	Buy	17	68.00%
Hold	14	28.00%	Hold	13	92.86%
Sell	11	22.00%	Sell	4	36.36%

### Equity Investment Rating Distribution: Global Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1877	53.28%	Buy	1040	55.41%
Hold	815	23.13%	Hold	464	56.93%
Sell	831	23.59%	Sell	385	46.33%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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