CAE Inc. (CAE)

Updated September 20th, 2018 by Nick McCullum

Key Metrics

Current Price:	$26	**5 Year CAGR Estimate:**	0.2%	**Volatility Percentile:**	20.2%
Fair Value Price:	$18	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	70.7%
% Fair Value:	144%	**5 Year Valuation Multiple Estimate:**	-7.3%	**Valuation Percentile:**	41.0%
Dividend Yield:	1.5%	**5 Year Price Target**	$24	**Total Return Percentile:**	29.2%

Overview & Current Events

CAE Inc. is the global leader in training and simulation devices for civil aviation, defense, military security, and healthcare employees. The company operates in three reporting segments, including Civil Aviation Training Solutions, Defense and Security, and Healthcare. CAE is headquartered in Montreal, Quebec, Canada and is cross-listed on both the Toronto Stock Exchange and the New York Stock Exchange, where it trades with a market capitalization of US$5.5 billion. The company reports financial results in Canadian dollars. Accordingly, all financial results in this report are in CAD and the company's TSX-listed shares have been used for the purpose of valuation analysis.

In mid-August, CAE reported (8/14/18) financial results for the first quarter of fiscal 2019. In the quarter, the company generated 10% revenue growth and 18% growth in earnings-per-share. CAE took in CAD$689.0 million new orders in the quarter, which caused its overall production backlog to increase by 6% to CAD$8.0 billion at the end of the reporting period. The company's robust growth was driven by its Civil Aviation Training Solutions segment, which delivered strong double-digit revenue growth and saw strong customer demand for the company's existing training solutions. More specifically, the company sold 26 civil full-slight simulators year-to-day and reached new long-term airline training partnerships with Singapore Airlines, Avianca Airlines, Jetstar Japan, and Asiana Airlines. Despite beating analyst expectations on both the top and bottom lines, CAE's shares fell by 4% on the first trading day following its earnings release.

To reward the company's shareholders for its strong financial performance, CAE announced an 11% increase to its quarterly dividend payment. This represents the company's eight consecutive dividend increase in as many years.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$0.79	$0.66	$0.66	$0.70	$0.74	$0.73	$0.76	$0.86	$1.03	$1.11	***$1.20***	***$1.61***
DPS	$0.10	$0.12	$0.15	$0.16	$0.19	$0.22	$0.26	$0.29	$0.31	$0.34	***$0.40***	***$0.59***
Shares	255.15	256.52	256.52	258.27	259.40	263.77	266.90	269.63	268.40	267.70	***268.00***	***275.00***

CAE has a strong growth outlook as the leader in the employee training and simulation industry. While the company has only managed to compound its adjusted earnings-per-share at 3% per year over the last decade, we believe its future growth will be superior to this. More specifically, we believe the company is likely to generate 6% earnings-per-share growth over full economic cycles. CAE is likely to report earnings-per-share of around $1.20 in the ongoing fiscal year (fiscal 2019). Applying a 6% growth rate to this earnings estimate allows us to calculate a fiscal 2024 earnings-per-share estimate of $1.61.

From a dividend perspective, CAE has a conservative payout ratio while simultaneously has communicated that returning capital to its shareholders it a top priority. Accordingly, we believe that CAE's dividend growth will outpace earnings growth for the foreseeable future. We are forecasting 8% growth in per-share dividend payments over the next 5 years.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	11.8	12.6	16.4	15.8	13.8	16.6	19.1	16.7	19.0	19.9	***21.9***	***15.0***
Avg. Yld.	1.1%	1.4%	1.4%	1.4%	1.9%	1.8%	1.8%	2.0%	1.7%	1.5%	-	-

CAE has traded at an average price-to-earnings ratio of 16.1 over the last decade. With that said, this time period includes three years (2017, 2016, and 2014) in which the company's stock was statistically overvalued. We believe fair value for a company like CAE lies somewhere around 15 times earnings. For context, the company is trading at a price-to-earnings ratio of 21.9 today. If the company's valuation were to contract to a price-to-earnings ratio of 15 over the next 5 years, this would reduce its annualized returns by a tremendous 7.3% per year.

Safety, Quality, Competitive Advantage, & Recession Resiliency

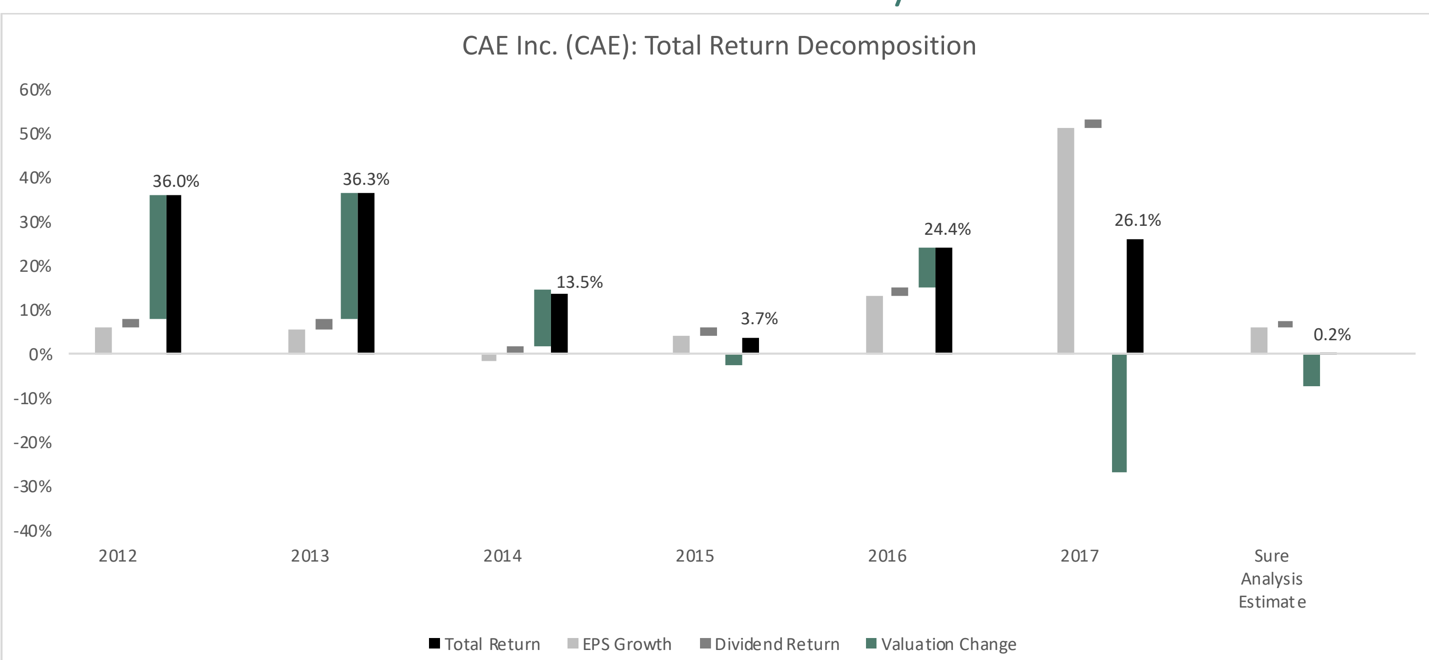
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
GP/A	11.5%	10.1%	19.5%	19.8%	15.8%	13.3%	13.0%	13.9%	15.1%	15.3%	***15.0%***	***15.0%***
Debt/A	55.1%	55.9%	66.9%	65.3%	68.9%	65.0%	63.8%	61.2%	61.1%	58.6%	***60.0%***	***55.0%***
Int. Cov.	15.3	9.3	4.8	4.4	3.7	4.3	5.0	4.7	5.3	6.2	***6.0***	***6.0***
Payout	12.7%	18.2%	22.7%	22.9%	25.7%	30.1%	34.2%	33.7%	30.1%	30.6%	***33.3%***	***36.6%***
Std. Dev.	35.6%	14.4%	24.7%	18.3%	18.5%	13.6%	12.5%	18.0%	15.4%	16.0%	***17.0%***	***17.0%***

CAE scores surprisingly well on a number of quality metrics. The company consistently covers its interest expense many times over with operating income, while debt has never exceeded three-quarters of its balance sheet and its payout ratio has usually tended below 33%. What truly stands out is the company's extremely low stock price volatility, which is low relative to our broad universe and especially low relative to its peers in the international equity space.

Final Thoughts & Recommendation

CAE's leadership in the business-to-business training and simulation industry do not overcome the stock's expensive valuation, which is set to materially reduce the company's total returns moving forward. Due to poor expected returns, CAE Inc. earns a sell recommendation from Sure Dividend at current prices.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.