CAE Inc. (CAE)

Updated August 21st, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$34	**5 Year CAGR Estimate:**	1.5%	**Volatility Percentile:**	26.6%
Fair Value Price:	$24	**5 Year Growth Estimate:**	7.0%	**Momentum Percentile:**	92.9%
% Fair Value:	142%	**5 Year Valuation Multiple Estimate:**	-6.8%	**Growth Percentile:**	69.0%
Dividend Yield:	1.3%	**5 Year Price Target**	$34	**Valuation Percentile:**	10.5%
Dividend Risk Score:	B	**Retirement Suitability Score:**	D	**Total Return Percentile:**	9.2%

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$6.8 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 (8/14/19) financial results for the first quarter of fiscal 2020. The company grew its revenue 14% over last year's quarter and received $941 million of new orders, thus increasing its backlog to $9.4 billion. Growth was led by Civil, which grew its operating income 29%. However, expenses greatly increased in the quarter and thus led adjusted earnings-per-share to fall from $0.26 to $0.24. Cost of sales jumped 16%, SG&A expenses rose 10% and interest expense more than doubled, from $16.0 million to $34.9 million. As the adjusted earnings-per-share missed analysts' consensus by $0.04 and the market had got used to strong earnings reports from CAE, the stock fell up to 15% on the day of the earnings release. However, the stock retrieved most of its losses on that day while management kept its outlook unchanged; it still expects growth in the new fiscal year though it has not provided specific figures. As we expect improved performance in the upcoming quarters, we have kept our forecast for this year intact.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$0.66	$0.66	$0.70	$0.74	$0.73	$0.76	$0.86	$1.03	$1.11	$1.25	***$1.40***	***$1.96***
DPS	$0.12	$0.15	$0.16	$0.19	$0.22	$0.26	$0.29	$0.31	$0.34	$0.40	***$0.44***	***$0.64***
Shares[1]	256.5	256.5	258.3	259.4	263.8	266.9	269.6	268.4	267.7	265.5	***264.0***	***250.0***

CAE has a strong growth outlook as the leader in the employee training and simulation industry, which is characterized by secular growth. While the company has only managed to compound its adjusted earnings-per-share at 4.7% per year over the last decade, we believe its future growth will be better. We expect the company to generate 7% earnings-per-share growth beyond fiscal 2020.

CAE has a conservative payout ratio while it has also communicated that returning capital to its shareholders is a top priority. The company recently raised its quarterly dividend by 10%. It has now raised its dividend for nine consecutive years. Thanks to the low payout ratio, 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 five years.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	12.6	16.4	15.8	13.8	16.6	19.1	16.7	19.0	19.9	20.8	***24.3***	***17.1***
Avg. Yld.	1.4%	1.4%	1.4%	1.9%	1.8%	1.8%	2.0%	1.7%	1.5%	1.5%	***1.3%***	***1.9%***

1. In millions.

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.

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CAE has traded at an average price-to-earnings ratio of 17.1 over the last decade. With the stock now trading at a price-to-earnings ratio of 24.3, the possibility of a meaningful valuation headwind is present. If this occurs, the stock will incur a -6.8% annualized drag due to the contraction of its valuation level.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	18.2%	22.7%	22.9%	25.7%	30.1%	34.2%	33.7%	30.1%	30.6%	32.0%	***31.4%***	***32.7%***

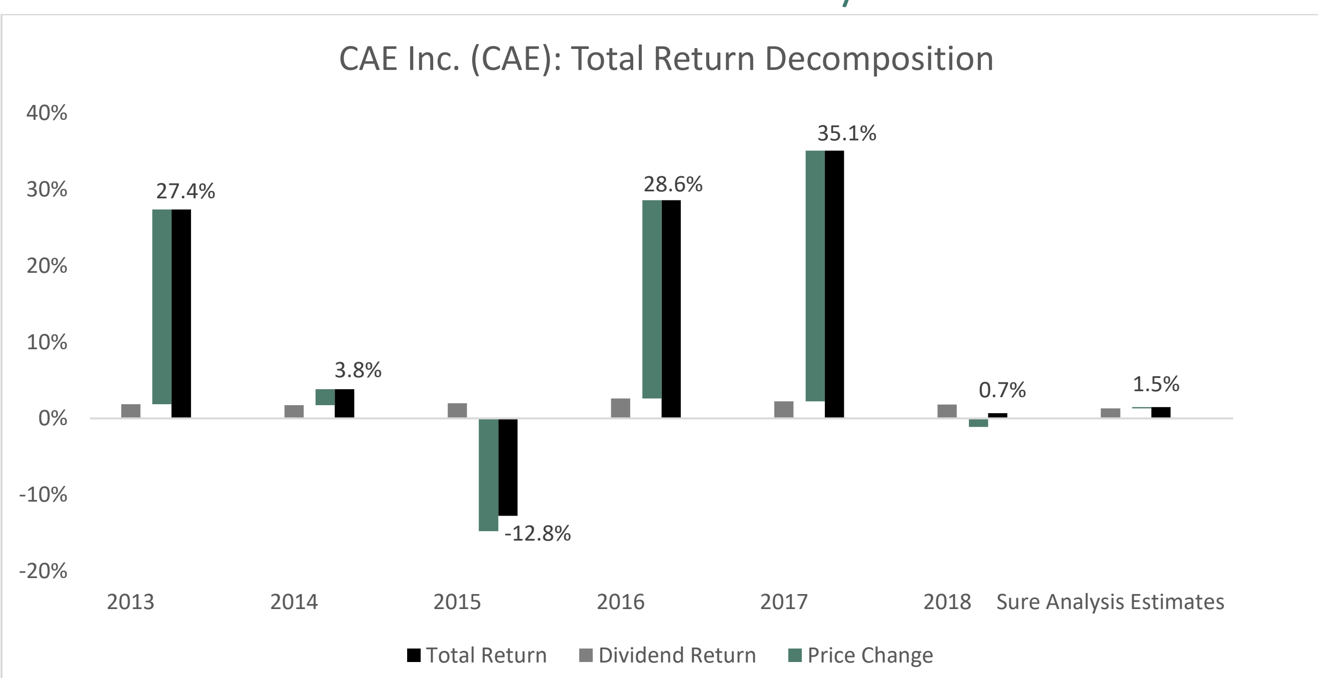
CAE operates in highly regulated industries, which have mandatory and recurring training requirements for the renewal of professional certifications. As a result, the company has long-term contracts with many airlines and business aircraft operators and a significant portion of its revenues are recurring. In addition, as CAE is the global leader in its business, it has a strong brand name, which provides a meaningful competitive advantage to the company.

Moreover, CAE has a healthy balance sheet, with its interest expense consuming only 15% of its operating income until recently. However, in the most recent quarter, interest expense jumped to 31% of operating income. We will monitor interest expense closely in the upcoming quarters in order to determine whether the financial condition of the company has weakened substantially.

Final Thoughts & Recommendation

CAE is the leader in the business-to-business training and simulation industry, with promising growth prospects ahead. However, the market has already priced a significant portion of future growth into the stock. As long as market sentiment remains positive, the stock could maintain its rich valuation but it will have significant downside risk whenever a downturn shows up. The 15% temporary plunge on the day of the latest earnings release confirms the excessive downside risk of the stock upon negative developments. Overall, CAE may offer a poor average annual return (1.5%0 over the next five years. We thus maintain our sell rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	1662	1526	1631	1821	2035	2078	2246	2513	2705	2830
Gross Profit	306	264	549	600	585	565	604	696	811	877
Gross Margin	18.4%	17.3%	33.7%	33.0%	28.7%	27.2%	26.9%	27.7%	30.0%	31.0%
SG&A Exp.	N/A	N/A	240	256	270	265	270	317	370	386
D&A Exp.	89	93	110	126	143	165	189	218	212	200
Operating Profit	306	196	283	288	256	246	275	312	337	375
Operating Margin	18.4%	12.8%	17.3%	15.8%	12.6%	11.8%	12.3%	12.4%	12.4%	13.3%
Net Profit	201	145	160	180	138	190	202	230	252	347
Net Margin	12.1%	9.5%	9.8%	9.9%	6.8%	9.1%	9.0%	9.1%	9.3%	12.3%
Free Cash Flow	-9	126	74	51	39	105	105	212	228	215
Income Tax	83	60	62	58	28	29	58	20	35	29

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	2666	2622	2817	3029	3691	4237	4657	4997	5355	5719
Cash & Equivalents	195	313	276	255	260	312	330	486	505	612
Accounts Receivable	322	238	191	302	247	295	291	294	334	346
Inventories	119	127	124	147	176	220	237	278	416	375
Goodwill & Int. Ass.	259	287	376	528	794	871	845	929	944	1056
Total Liabilities	1468	1466	1884	1978	2545	2755	2971	3056	3274	3353
Accounts Payable	N/A	N/A	253	556	269	288	276	305	317	306
Long-Term Debt	684	493	660	708	1047	1142	1258	1252	1235	1244
Shareholder’s Equity	1198	1156	914	1031	1115	1442	1635	1889	2021	2298
D/E Ratio	0.57	0.43	0.72	0.69	0.94	0.79	0.77	0.66	0.61	0.54

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	8.2%	5.5%	5.9%	6.2%	4.1%	4.8%	4.5%	4.8%	4.9%	6.3%
Return on Equity	18.7%	12.3%	15.5%	18.5%	12.8%	14.9%	13.1%	13.0%	12.9%	16.1%
ROIC	12.5%	8.2%	9.9%	10.8%	7.0%	7.9%	7.2%	7.5%	7.7%	10.0%
Shares Out.	255.15	256.52	256.52	258.27	259.40	263.77	266.90	269.63	268.40	267.70
Revenue/Share	6.52	5.97	6.33	7.05	7.85	7.93	8.44	9.33	10.03	10.50
FCF/Share	-0.04	0.49	0.29	0.20	0.15	0.40	0.39	0.79	0.85	0.80

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.