CAE Inc. (CAE)

Updated February 10th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$31	**5 Year CAGR Estimate:**	-0.3%	**Market Cap:**	$8.0 B
Fair Value Price:	$19	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	3/12/2020
% Fair Value:	160%	**5 Year Valuation Multiple Estimate:**	-9.0%	**Dividend Payment Date:**	3/31/2020
Dividend Yield:	1.1%	**5 Year Price Target**	$28	**Years Of Dividend Growth:**	12
Dividend Risk Score:	B	**Retirement Suitability Score:**	F	**Last Dividend Increase:**	10.0%

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$8.0 billion. The company reports financial results in Canadian dollars, but we have converted all the figures to USD for the purpose of valuation analysis.

In early February, CAE reported (2/7/20) financial results for the third quarter of fiscal 2020. The company grew its revenue by 13% and its earnings-per-share by 28% over prior year's quarter. Growth resulted from strong performance in both Civil and Defense, which grew their operating income by 42% and 32%, respectively. CAE also received $1.1 billion of new orders. As a result, its backlog increased from $9.0 billion in prior year's quarter to $9.4 billion.

Management kept its outlook unchanged; it still expects almost 30% growth in operating income in Civil thanks to strong demand for its training solutions and mid-to-high single-digit growth in operating income in Defense thanks to its strong pipeline.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$0.64	$0.67	$0.70	$0.72	$0.64	$0.57	$0.62	$0.79	$0.86	$0.94	***$1.05***	***$1.54***
DPS	$0.12	$0.15	$0.16	$0.18	$0.19	$0.20	$0.21	$0.24	$0.26	$0.30	***$0.33***	***$0.50***
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. Its growing backlog, which is worth approximately 2.5 years' revenues, bodes well for the growth potential of the company while it also provides a buffer in the event of a downturn. We expect the company to generate 8% 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 has raised its dividend for over a decade. Thanks to the low payout ratio, CAE's dividend growth may outpace earnings growth in the upcoming years.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	16.4	15.8	13.8	16.6	19.1	16.7	19.0	19.9	20.8	25.9	***29.5***	***18.4***
Avg. Yld.	1.4%	1.4%	1.9%	1.8%	1.8%	2.0%	1.7%	1.5%	1.5%	1.2%	***1.1%***	***1.8%***

[1] In millions.

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CAE has traded at an average price-to-earnings ratio of 18.4 over the last decade. With the stock now trading at a price-to-earnings ratio of 29.5, the possibility of a meaningful valuation headwind is present. If the stock reverts to its average valuation level over the next five years, it will incur a -9.0% annualized drag in its returns.

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%	***31.5%***	***32.2%***

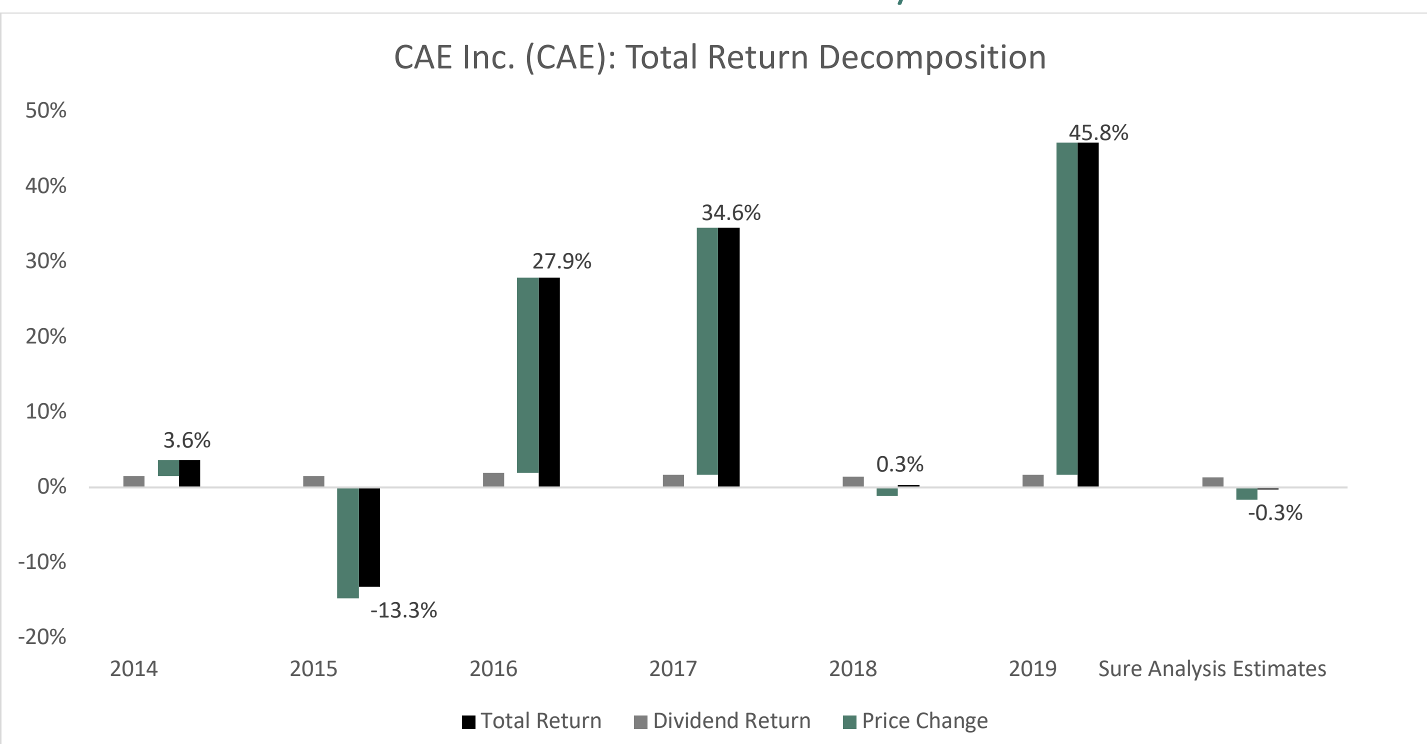
CAE operates in highly regulated industries, which have mandatory and recurring training requirements for the renewal of professional certifications. As a result, the company has long-term contracts with many airlines and business aircraft operators and a significant portion of its revenues are recurring. 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. While its interest expense has increased in recent quarters, it is still consuming only 27% of its operating income and hence it stands at an easily manageable level, particularly given the growth trajectory of the company.

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 great portion of future growth into the stock. As long as the market sentiment remains positive, the stock may maintain its rich valuation, but it will have significant downside risk whenever a downturn shows up. The -15% decline in the share price on the day of a past earnings release confirms the excessive downside risk of the stock upon negative developments. Overall, CAE may offer a poor average annual return over the next five years. We thus maintain our sell rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	1,403	1,601	1,835	2,033	1,974	1,979	1,918	2,060	2,205	2,518
Gross Profit	243	539	604	584	537	532	531	618	686	717
Gross Margin	17.3%	33.7%	33.0%	28.7%	27.2%	26.9%	27.7%	30.0%	31.1%	28.5%
SG&A Exp.		236	258	264	246	233	238	278	297	316
D&A Exp.	86	108	127	143	156	167	166	161	156	166
Operating Profit	180	277	290	261	238	247	244	260	297	318
Operating Margin	12.8%	17.3%	15.8%	12.8%	12.1%	12.5%	12.7%	12.6%	13.5%	12.6%
Net Profit	133	157	182	138	181	178	175	192	270	251
Net Margin	9.5%	9.8%	9.9%	6.8%	9.1%	9.0%	9.1%	9.3%	12.3%	10.0%
Free Cash Flow	116	73	51	39	100	92	162	174	142	146
Income Tax	55	61	58	28	28	51	16	27	24	45

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	2,581	2,899	3,038	3,633	3,833	3,673	3,849	4,048	4,476	5,367
Cash & Equivalents	308	284	255	256	283	260	374	378	474	334
Accounts Receivable	234	197	303	243	267	229	227	338	268	275
Inventories	125	128	147	173	199	187	214	412	400	402
Goodwill & Int. Ass.	283	387	530	782	788	666	716	708	817	1,519
Total Liabilities	1,443	1,939	1,984	2,505	2,492	2,343	2,355	2,539	2,697	3,562
Accounts Payable		260	558	264	261	218	235	514	237	344
Long-Term Debt	485	679	710	1,030	1,033	992	965	941	963	1,697
Shareholder's Equity	1,138	941	1,034	1,097	1,304	1,290	1,455	1,464	1,726	1,746
D/E Ratio	0.43	0.72	0.69	0.94	0.79	0.77	0.66	0.64	0.56	0.97

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	5.7%	5.7%	6.1%	4.1%	4.8%	4.7%	4.7%	4.9%	6.3%	5.1%
Return on Equity	12.7%	15.1%	18.4%	12.9%	15.0%	13.7%	12.8%	13.1%	16.9%	14.5%
ROIC	8.5%	9.6%	10.7%	7.0%	8.0%	7.6%	7.3%	7.8%	10.4%	8.1%
Shares Out.	256.5	256.5	258.3	259.4	263.8	266.9	269.6	268.4	267.7	265.5
Revenue/Share	5.48	6.22	7.10	7.84	7.54	7.44	7.13	7.64	8.18	9.40
FCF/Share	0.45	0.28	0.20	0.15	0.38	0.35	0.60	0.65	0.53	0.55

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