CAE Inc. (CAE)

Updated May 24th, 2021 by Aristofanis Papadatos

Key Metrics

Current Price:	$30	**5 Year CAGR Estimate:**	0.8%	**Market Cap:**	$8.7 B
Fair Value Price:	$17	**5 Year Growth Estimate:**	13.0%	**Ex-Dividend Date:**	N/A
% Fair Value:	177%	**5 Year Valuation Multiple Estimate:**	-10.8%	**Dividend Payment Date:**	N/A
Dividend Yield:	N/A	**5 Year Price Target**	$31	**Years Of Dividend Growth:**	N/A
Dividend Risk Score:	N/A	**Retirement Suitability Score:**	N/A	**Last Dividend Increase:**	N/A

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$8.7 billion. The company reports financial results in Canadian dollars, but we have converted all the figures to USD for this report.

On March 1st, 2021, CAE finalized the acquisition of the Military Training business of L3Harris Technologies for $1.05 billion. This deal, which is expected to close in the second half of the year, will enhance the annual revenues of CAE by ~$500 million. As the amount of the transaction is 12% of the market cap of CAE and annual revenue is likely to grow approximately 20%, it is evident that this acquisition is a major one. Indeed, CAE expects the deal to enhance its earnings per share at a low-teens rate in the first full year after the completion of the transaction.

In mid-May, CAE reported (5/19/21) financial results for the fourth quarter of fiscal 2021. The pandemic continued to weigh on the company due to mandatory facility closures and travel restrictions. Revenue decreased -33% over last year's quarter but adjusted loss-per-share narrowed from -$0.18 to -$0.08. The pandemic has caused a collapse in air traffic and thus it has put airlines under great pressure. As a result, CAE has suspended its dividend and share repurchases. On the bright side, CAE believes that the worst is behind the company and expects to become free cash flow positive in the second half of its fiscal 2022.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$0.70	$0.72	$0.64	$0.57	$0.62	$0.79	$0.86	$0.94	$1.01	$0.10	***$0.84***	***$1.55***
DPS	$0.16	$0.18	$0.19	$0.20	$0.21	$0.24	$0.26	$0.30	$0.33	$0.08	---	---
Shares[1]	258.3	259.4	263.8	266.9	269.6	268.4	267.7	265.5	265.6	287.3	***290.0***	***290.0***

CAE is facing an unprecedented downturn in its business due to the pandemic, which has caused extreme financial stress to airlines. However, we expect the pandemic to attenuate and CAE to begin to recover later this year, though we expect a gradual recovery. In the long run, CAE has a strong growth outlook as the leader in the employee training and simulation industry, which is characterized by secular growth. CAE is also likely to emerge stronger from the pandemic thanks to its aforementioned acquisition and its restructuring program, which aims to reduce annual operating costs by $50 million. We expect CAE to generate 13% average annual earnings-per-share growth over the next five years.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	13.8	16.6	19.1	16.7	19.0	19.9	20.8	25.9	25.2	---	***35.7***	***20.2***
Avg. Yld.	1.9%	1.8%	1.8%	2.0%	1.7%	1.5%	1.5%	1.2%	1.3%	0.4%	---	---

[1] In millions.

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CAE has traded at an average price-to-earnings ratio of 20.2 over the last decade. The stock is now trading at 35.7 times its expected earnings, a decade-high valuation level. If the stock reverts to its average valuation level over the next five years, it will incur a -10.8% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	22.9%	25.7%	30.1%	34.2%	33.7%	30.1%	30.6%	32.0%	32.8%	80.0%	---	---

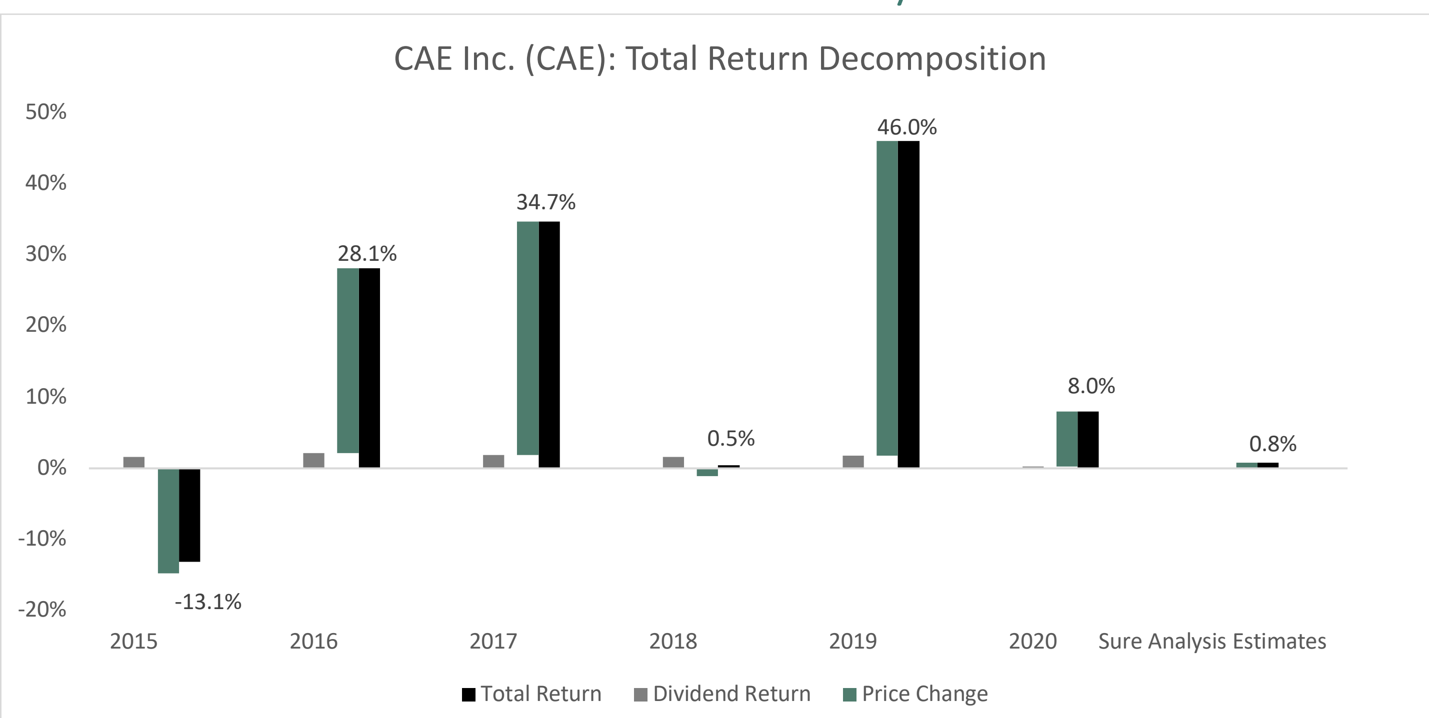
CAE operates in highly regulated industries, which have mandatory and recurring training requirements for the renewal of professional certifications. As a result, the company has long-term contracts with many airlines and business aircraft operators and a significant portion of its revenues are recurring. 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 37% of its operating income and hence it stands at a manageable level. The company can endure the coronavirus crisis and it is likely to recover strongly after the end of the pandemic.

Final Thoughts & Recommendation

CAE is the leader in the business-to-business training and simulation industry but it is now facing an unprecedented downturn in its business. However, we expect the pandemic to subside and the airline industry to begin to recover in the second half of this year. For those who want to invest in the recovery of the airline industry, CAE is much safer than airlines, as the former has a much healthier balance sheet than most airlines and has remained profitable, in sharp contrast to airlines. On the other hand, the stock has doubled in just six months thanks to the massive vaccination program underway. In other words, the market has already priced a strong recovery in the stock. As a result, CAE could offer lackluster returns over the next five years and thus receives a sell rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	1,601	1,835	2,033	1,974	1,979	1,918	2,060	2,205	2,518	2,725
Gross Profit	539	604	584	537	532	531	618	686	717	815
Gross Margin	33.7%	33.0%	28.7%	27.2%	26.9%	27.7%	30.0%	31.1%	28.5%	29.9%
SG&A Exp.	236	258	264	246	233	238	278	297	316	329
D&A Exp.	108	127	143	156	167	166	161	156	166	230
Operating Profit	277	290	261	238	247	244	260	297	318	375
Operating Margin	17.3%	15.8%	12.8%	12.1%	12.5%	12.7%	12.6%	13.5%	12.6%	13.8%
Net Profit	157	182	138	181	178	175	192	270	251	234
Net Margin	9.8%	9.9%	6.8%	9.1%	9.0%	9.1%	9.3%	12.3%	10.0%	8.6%
Free Cash Flow	73	51	39	100	92	162	174	142	146	121
Income Tax	61	58	28	28	51	16	27	24	45	55

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	2,899	3,038	3,633	3,833	3,673	3,849	4,048	4,476	5,367	5,982
Cash & Equivalents	284	255	256	283	260	374	378	474	334	667
Accounts Receivable	197	303	243	267	229	227	338	268	275	318
Inventories	128	147	173	199	187	214	412	400	402	434
Goodwill & Int. Ass.	387	530	782	788	666	716	708	817	1,519	1,450
Total Liabilities	1,939	1,984	2,505	2,492	2,343	2,355	2,539	2,697	3,562	4,164
Accounts Payable	260	558	264	261	218	235	514	237	344	381
Long-Term Debt	679	710	1,030	1,033	992	965	941	963	1,697	2,071
Shareholder's Equity	941	1,034	1,097	1,304	1,290	1,455	1,464	1,726	1,746	1,756
D/E Ratio	0.72	0.69	0.94	0.79	0.77	0.66	0.64	0.56	0.97	1.18

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	5.7%	6.1%	4.1%	4.8%	4.7%	4.7%	4.9%	6.3%	5.1%	4.1%
Return on Equity	15.1%	18.4%	12.9%	15.0%	13.7%	12.8%	13.1%	16.9%	14.5%	13.4%
ROIC	9.6%	10.7%	7.0%	8.0%	7.6%	7.3%	7.8%	10.4%	8.1%	6.4%
Shares Out.	256.5	258.3	259.4	263.8	266.9	269.6	268.4	267.7	265.5	265.6
Revenue/Share	6.22	7.10	7.84	7.54	7.44	7.13	7.64	8.18	9.40	10.18
FCF/Share	0.28	0.20	0.15	0.38	0.35	0.60	0.65	0.53	0.55	0.45

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