CAE Is Off To A Flying Start in 2013

Description

CAE (TSX:CAE) announced this morning that it had secured more than $100 million in military contracts for the defense forces of 15 countries. Included in this client list was the Israeli Air Force, UK Ministry of Defense, and NATO. It was just last week that the company announced $95 million worth of deals that included the sale of seven full flight simulators and a series of training devices and simulator update services. For a company that generated nearly $2 billion in revenues over the past 12 months, $200 million in contracts isn't overly material, however, it provides an indication that CAE's products and services remain in demand around the world.

The company's focus is on helping train people to fly airplanes and helicopters of all shapes and sizes. They do so primarily by providing market leading flight simulator technologies. In addition, CAE offers a suite of ancillary training services related to the industry of flight (ie. cabin crew training, aircraft maintenance technician training).

Revenues have grown at a CAGR of 7% over the past 5 years and the company consistently rings through a return on equity of 15-16%. Free cash generation is positive but not abundant, and though the balance sheet is perhaps a little heavy with debt (Total debt/equity = 119%), the company's coverage ratios indicate that this is of little concern. In addition, the stock offers a dividend yield of 1.9%.

Potential clouds

This is a very solid small/mid cap company in the Canadian market. Somewhat of a rarity. However, one of the knocks against CAE is its exposure to global defense spending which accounted for 49% of 2012 revenues. In addition, though globally diversified, and growing in the parts of the world you'd expect (emerging markets), the U.S. and Europe contributed 34% and 30% of 2012 revenues respectively. Spending, especially on defense, in these two major markets could face cuts in the coming years and this may have a negative impact on CAE.

CAE's business model could however allow it to escape any spending cuts relatively unscathed as they are a low cost provider of flight training. The cost of operating a flight simulator is a fraction of what an actual airplane costs to operate, and therefore, as budget cuts roll through, simulators may in fact take on a more prevalent role in pilot training.

Given the embedded cost advantage, it would be far easier to ignore the potential spending headwind if the stock was trading at a more reasonable valuation. At a current P/E multiple of 17.9 and P/Book of 2.8, the company trades in line with 10 year averages of 17.8 and 2.5. The stock appears fairly valued.

Foolish bottom line

CAE is a great example of company that exhibits sound fundamentals and a world leading product that would make a great addition to a portfolio, at the right price. Even if spending cuts weren't a potential issue, a quick look at CAE indicates it is fairly priced. Throw the potential spending cut risk into the mix and the stock is perhaps on the expensive side. Given these characteristics, this is a great company to sit on and wait for either the market to pull back or a company specific hiccup somewhere along the line.

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CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:CAE (CAE Inc.)

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