CAE Inc. (TSX:CAE) Follows the Rule of 72

Description

Are you familiar with the Rule of 72? Many investors are. For those who aren't, it's a simple rule to figure out how many years it will take a stock's price to double.

In the case of **CAE** (TSX:CAE)(NYSE:CAE), the Montreal company specializing in flight simulators, its shares doubled in price from $12 in November 2013 to $24 today. So, divide the number of years into 72, and you get an annual return of 14.4%.

However, the rule doesn't take into account dividends. If you add those, CAE stock has generated an annualized total return over the past five years of 16.2% — or 180 basis points higher.

If I'd asked you five years ago if you'd be happy with a five-year annual total return of more than 16%, I'm pretty sure you would have said yes. Oh, by the way, the **S&P/TSX Composite Index** over the same period had an annualized total return of 6%, less than half CAE's performance.

Up just 3.5% year to date through November 7, CAE has got a lot of work to do if it wants to deliver a repeat performance for shareholders.

Can it do it? I believe it can. Here's why.

The training market for pilots is huge

According to a 2017 report entitled "Airline Pilot Demand Outlook", an estimated 255,000 new commercial pilots will be needed to meet the demands of global travelers.

Given the shortage of pilots, *training* is the keyword for CAE growth.

"All those pilots will need to be trained," Al Contrino, a CAE executive responsible for business development stated earlier this year. "Our objective is that they train with CAE, either at our training centres or on our equipment."

Simulators, which cost anywhere between $8 million and $20 million a pop depending on the aircraft, have a ceiling regarding the number purchased each year. In 2000, CAE had 70% of the global market share in flight simulators.

If it focused solely on selling machines and not the actual training needed to use them effectively, its share price wouldn't be nearly as high as it is today.

"We estimate the total global civil aviation training market is six times larger than the market for selling simulators," Contrino said. "This is where we will be able to grow our business over the long term."

Training now accounts for 60% of the company's annual revenue.

Acquisitions can goose growth

CAE announced November 8 that it was paying US$645 million to acquire **Bombardier's** Business Aircraft Training (BAT) unit, including the assumption of debt. Also, it will pay an additional US$155 million to monetize its future royalty obligations to Bombardier.

"The acquisition increases CAE's ability to address the long-term and growing market demand for business aviation professionals," the company stated in its press release announcing the deal. "CAE estimates that there will be a need for 50,000 new business aviation pilots over the next 10 years."

CAE expects the deal to be accretive to earnings and cash flow and will provide it with significant recurring and instructor-led training revenue.

CAE paid approximately nine times its forward EBITDA — a reasonable multiple considering the advantage it gains in one of the fastest-growing segments of business aviation training.

And, if you're a Bombardier shareholder, it strengthens the company's financial position.

A repeat of the Rule of 72

Investors naturally look to CAE's civil aviation business because it accounts for 60% of the company's overall revenue. However, as Fool contributor Ambrose O'Callaghan stated in May, CAE has a defence business that's likely to benefit in the years ahead from increased military spending.

Add to this a healthcare business that's struggled to get off the ground but could be a potential wildcard, and you've got a company that's likely to continue growing revenue 8-10% a quarter.

Should you own CAE stock? Heck, yes.

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