3 Reasons You Want This Training Stock in Your TFSA

Description

It's been a great year on the markets for Montreal-based **CAE** (TSX:CAE)(NYSE:CAE).

Best known for the flight simulators it manufactures and sells to airlines around the world, its stock is up 38% year to date through May 22. However, its share price has started to retreat in recent days after several analysts downgraded CAE stock due to valuation concerns.

Benoit Poirier, an analyst at Desjardins Securities, downgraded CAE to "hold" from "buy" this week, suggesting that although Desjardins remains confident in the company's long-term prospects, its share price is fairly valued. **Bank of Montreal** also downgraded CAE from buy to hold.

Trading within 10% of CAE's all-time high, it's not hard to see why analysts have cooled on the stock. Investors, following the analysts' lead, have knocked several dollars off its share price in post-Victoria Day trading.

Although CAE is trading at almost 25 times its forward P/E ratio, I believe it's got the right stuff to keep moving higher.

Here are three reasons why.

A record year

CAE reported its fourth-quarter results May 17 and they were outstanding.

On the top line, CAE's sales rose 42% to $1.0 billion. On the bottom line, its net income grew 46% during the quarter to $170.4 million.

“We had a strong finish to fiscal year 2019, with fourth-quarter revenue up 42% and earnings per share up 55% compared to last year; and for the year as a whole, CAE delivered a record performance, meeting our annual outlook, and further establishing itself as the worldwide leader in aviation training,” said Marc Parent, CAE’s President and Chief Executive Officer.

Two things that caught my eye in the final earnings report of the fiscal year was the size of its backlog and its free cash flow.

CAE finished the year with a record $4 billion in annual orders including 78 full-flight simulators (FFSs), a $9.5 billion backlog, and $324 million in free cash flow, 12% higher than in fiscal 2018.

Also useful is the rate at which it converted its net income to cash in 2019. At 98%, CAE is getting the job done for shareholders.

Demand for pilots

Late in 2018, I suggested that investors forget about the airlines and buy CAE.

My rationale had everything to do with the future demand for pilots as globalization increases the amount of passenger travel. There’s a pilot shortage at the moment; a flight simulator and training company like CAE is going to benefit from the growth in commercial aviation directly.

In fiscal 2020, CAE expects to continue to gain market share in the flight training industry, including selling plenty of full-flight simulators to airlines and training centres around the world.

As a result, it sees its civil aviation business growing operating income by 20% or more this year, with high single-digit operating income growth in its defense business, and double-digit growth from its healthcare unit.

Global military spending way up

Fool contributor Ambrose O’Callaghan recently highlighted a big reason investors ought to be interested in CAE stock, and it had nothing to do with the company’s civil aviation division.

Instead, O’Callaghan was touting the strength of the company’s defense and security division, which had recently snagged a $250 million contract from the U.S. Air Force and another from a consortium of European countries.

In fiscal 2019, its defence and security business increased revenues and operating profits by 21% and 6%, respectively to $1.3 billion and $131.5 million. Although its operating margin was slightly lower in 2019, its backlog grew 13% to $4.5 billion or 47% of the company’s overall backlog.

A big reason for the record backlog at defence was the $1.1 billion in orders it took in during the past year.

Civil aviation might get the spotlight, but record military spending suggests CAE’s defence business isn’t slowing anytime soon.

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