FINAL TRANSCRIPT

Chorus Aviation Inc.

First Quarter 2019 Earnings Analyst Call

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PRESENTATION

Operator

Good morning, my name is Julianne, and I'll be your conference Operator today. At this time, I would like to welcome everyone to the Chorus Aviation Incorporated First Quarter 2019 Earnings Analyst Call. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question press the # key. Thank you.

Nathalie Megann, Vice President, Investor Relations, you may begin your conference.

Nathalie Megann — Vice President, Investor Relations and Corporate Affairs, Chorus Aviation Inc.

Thank you, Julianne. Hello, and thank you for joining us today for our first quarter 2019 conference call and audio webcast.

With me today from Chorus are Joe Randell, President and Chief Executive Officer; Jolene Mahody, Executive Vice President and Chief Strategy Officer; and our newly appointed Chief Financial Officer, Gary Osborne. Welcome, Gary.

We'll start by giving a brief overview of the results and then go on to questions from the analyst community.

Because some of the discussion in this call may be forward looking, I direct your attention to the caution regarding forward-looking statements and information, which is subject to various risks, uncertainties, and assumptions that are included or referenced on Page 41 of our Management's Discussion and Analysis of the results and operations of Chorus Aviation Inc. for the period ended March 31, 2019, the Outlook section, and other sections of our MD&A where such statements appear.

In addition, some of the following discussion involves certain non-GAAP financial measures, including references to EBITDA, adjusted EBITDA, and adjusted net income. Please refer to Section 17 of our MD&A for a discussion related to the use of such non-GAAP measures.

I'll now turn the call over to Joe Randall.

Joe Randell — President and Chief Executive Officer, Chorus Aviation Inc.

Thank you, Nathalie, and good morning, everyone. Thank you for joining us. We've made significant advancements in transforming Chorus into an international player in regional aviation, and I'm very pleased with how this year is progressing.

In a few minutes, you'll be hearing from our newly appointed Chief Financial Officer, Gary Osborne. Gary has been in the industry for over 25 years and recently served as Vice President, Finance and Business Services at Jazz. Jolene Mahody and the team will be supporting Gary as he transitions into this new role, and I know our analysts will enjoy working with him.

Now turning to our accomplishments to date and the first quarter highlights. Our strengthened strategic partnership with Air Canada announced at the start of the year was a pivotal development in our transformation. Our amended and extended CPA secures and expands Jazz's place in Air Canada's regional network, extending our relationship under the agreement by an unprecedented additional 10 years out to 2035, and enhances our relevance to Air Canada as they consolidate more of their overall regional capacity into Jazz.

The implementation of the CPA is going well. We intend to induct five CRJ900s, sourced by Air Canada, over the next few months and to acquire nine new CRJ900s in 2020 that will generate leasing revenue under the CPA.

The pilot flow agreement with Air Canada is going smoothly, and we are not having difficulty backfilling pilot positions, as we've become one of the most attractive employers in the Canadian aviation industry, offering candidates appealing lifestyle and career options. Air Canada is committed to hiring 60 percent of its new pilots from Jazz, which is a great draw for those aspiring to fly for one of the world's greatest airlines.

We have great working relationships with 13 aviation schools and with the Canadian Armed Forces Cadet Program, both of which are good sources for pilots. Since January of 2015, over 630 pilots have flowed to Air Canada.

Now turning to our growing leasing business where our momentum continues. In the quarter, we completed two significant leasing transactions that increased our portfolio by 11 aircraft.

The first was our transaction with Elix Aviation for six aircraft consisting of two ATRs leased with Azul Airlines of Brazil, two Q400s leased with Ethiopian Airlines, and two Q400s leased to Jambojet of Kenya.

The second brought a new customer, SpiceJet of India, to whom we will lease five new Q400s. India is one of the fastest-growing air travel markets in the world, and we're pleased to welcome this award-winning and growing airline to our portfolio of lessees. These leases will result in increased near-term earnings, as three of the aircraft have been delivered with the balance to be placed by the end of June.

Upon delivering the two remaining aircraft to Spicejet and five other aircraft pending delivery to other customers, Chorus Aviation Capital will grow its portfolio to 45 aircraft acquired at approximately 960 million US, with approximately 745 million US in future contract lease revenue. The portfolio is well diversified, consisting of 33 turboprops and 12 regional jets from all three regional aircraft equipment manufacturers and placed with 13 customers based on six continents.

By 2020, when you factor in the aircraft lease under the CPA, we'll have 110 aircraft under lease with a net book value of approximately 1.8 billion US. We're maintaining our guidance of having the balance of the capital we have on hand committed by early 2020.

We're maturing and building scale as a worldwide lessor. With our core business with Air Canada established for the next 17 years, we're now focused more deeply on leveraging our vast expertise in regional operations to secure more growth and diversification. The recent realignment of our chief executives will accomplish this.

Jolene Mahody takes on her new role as Executive Vice President and Chief Strategy Officer today and is responsible for strategic and corporate planning, mergers and acquisitions, in addition to investor relations and corporate affairs activities.

Further, Colin Copp, our newly appointed Chief Operating Officer and President of Chorus Aviation Services, will lead the development of new commercial opportunities to grow the contract flying, parts provisioning, and maintenance functions at Jazz and Voyageur. He will leverage the technical expertise within Jazz and Voyageur to bolster our business, create new opportunities, and to support Chorus Aviation Capital.

Our C-suite represents 165 years of cumulative experience in our industry. I'm pleased with our succession planning and the continuity and commitment of our core senior executive team.

Regional aviation is a resilient sector of the industry, and we are well positioned to bring our organization to the next level. Over 90 percent of our revenues are embedded in long-term contracts for flying operations and aircraft leasing, providing quantifiable and predictable revenue streams.

Under the CPA, Air Canada manages all commercial aspects of the Air Canada Express operation and assumes the related risks, including fluctuating fuel prices and passenger demand. We have strengthened the CPA not only through the 10-year extension to 2035; we've also minimized potential profit margin erosion to $2 million annually with the implementation of the guardrails on controllable costs.

Historically, during economic downturns, mainline carriers typically contract more flying to their regional partners to lower costs and increase their utilization of smaller aircraft which are better suited to serve reduced market demand. Further, airlines look to the benefits of leasing aircraft versus acquiring them to allow for better operational flexibility and reduced financing requirements.

We take a process-driven, conservative approach to building our leasing business and utilize several risk-mitigation strategies that analyze the risks associated with potential aircraft transactions. When possible, on a portfolio basis, the term of the aircraft debt is fixed with the term of the lease and in the same currency, thus providing foreign exchange protection. The objective is to maintain a diversified customer base with good future prospects, seek geographic diversification, and limit aircraft type concentration.

Regional aircraft are mature and efficient and turboprops, which make up the majority of our total fleet, are generally resistant to technological obsolescence. In fact, we believe regional aircraft, especially turboprops, hold strong residual value when compared to narrow and widebody aircraft. And extended service programs are currently available for Dash 8–100 and 300 series aircraft, and we've completed eight of these programs on Dash 8–300s to date.

The combination of being a highly experienced regional operator and our ability to manage every stage of an aircraft's life from origination to disposition is a strength that differentiates us from our competition. We generate value at every stage of an aircraft's life cycle. At the end of the lease term, we will have multiple potential uses for these aircraft, including lease extensions, re-leases, sale to new operators, conversion to non-passenger use, or disassembly for part sales. We can provide a wide range of services and can leverage the synergies across our organization to support our lessees.

Due to the low-risk nature of our business model, the quality of our customers and the associated revenues, and our resilient position in the event of negative changes in market conditions, we are well positioned to seize new opportunities to profitably grow and diversify. I'm very optimistic about our future as we build more value for our stakeholders.

I congratulate the Chorus team for delivering another solid quarter and look forward to future accomplishments. Thank you.

And I'll now pass the line over to Gary to take you through the first quarter results.

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

Thank you, Joe, and good morning. Our group of companies had a strong performance in the first quarter, and our financial results came in as anticipated. This is our first quarterly report out with the implementation of the CPA method that includes reduced fixed margin and incentive revenue, as we are now at market-based compensation rates.

Here's how the quarter compares to the same period last year. We generated adjusted EBITDA of 74.7 million, a decrease of 2.9 million, or 3.7 percent relative to the first quarter of 2018. The Regional Aviation Services segment decreased by 9.3 million quarter over quarter. The decrease is reflective of the CPA amendments I just mentioned, which were offset by the implementation of the controllable cost guardrails that mitigated the rate compression typically experienced in the first quarter due to the seasonality of flying and the associated costs under the CPA. Historically, the first quarter had the largest margin compression of any quarter.

Beyond the changes related to the amended CPA, the first quarter results were impacted by increased stock-based compensation of 7.7 million due to the strengthening of the share price, offset by increased leasing under the CPA from the extended service program conversions of the Dash 8–300s.

The Regional Airline Leasing segment had a $6.5 million increase in adjusted EBITDA quarter over quarter, with the average aircraft equivalents increasing from 21 to 31. In support of our expanding leasing operation and customer base, SG&A expense increased by 1.1 million quarter over quarter, as expected.

Adjusted net income of 19 million decreased from 2018 by 7.7 million or 28.6 percent, due to the $2.9 million decrease in adjusted EBITDA previously described, an increase in depreciation of 3.1 million related to additional aircraft in the Regional Aircraft Leasing segment, and an increase in interest costs of 1.9 million related to additional aircraft debt.

Net income increased by 28.2 million to 33.4 million, or $0.22 per basic share for the period. The increase is primarily due to a quarter-over-quarter change in unrealized foreign exchange gains on long-term debt of 34.7 million and decreased employee separation costs of 3.1 million. This was offset by the previously noted 7.7 million decrease in adjusted net income and onetime signing bonuses of 2 million related to changes in the Jazz pilot collective agreement.

Looking ahead to the balance of the year, capital expenditures for 2019, excluding those for the acquisition of aircraft and the E&P and including capitalized major maintenance overhauls are expected to be between 34 million and 40 million. Capital expenditures for E&P and aircraft acquisitions are expected to be between 428 million and 433 million in 2019. This does not include capital for future to be announced aircraft acquisitions.

We changed our schedule of planned ESPs to align with CPA amendments, and as such, we anticipate conducting four ESPs this year, five in 2020, and the balance completed before the end of 2022.

As at March 31st, approximately 75 percent of the total net proceeds of 401 million raised to grow the leasing business has been invested, including deposits on future commitments and deposits on the nine CRJ900s that will be leased into the CPA operation.

We have also committed an additional 15 percent and announced future transactions bringing the total capital committed to 90 percent. We anticipate fully committing the remaining net proceeds by early 2020 as we continue to expand our leasing business and our high-quality group of customers around the world.

Chorus expects to close on aircraft financings totalling approximately C$95 million in the second quarter of this year, including a draw on our US$300 million warehouse facility. The aircraft financed were previously cash financed prior to March 31, 2019.

For additional information supporting our projected guidance for the balance of this year, I'll refer you to Section 4, the 2019 Outlook section of our MD&A for the period ended March 31, 2019

On January 1st of this year, we adopted IFRS 16 for leases using the retrospective approach with restatement of comparative periods. The impact of this adoption of this new standard is provided in Section 13 of our MD&A and in Note 3 of our financial statements. With our implementation of IFRS 16, all aircraft rent expense has been eliminated from the income statement as it relates to aircraft leased from Air Canada for services provided under the CPA.

As such, we've removed the reference to EBITDAR in our financial disclosure, as we no longer have lease rental expense in our consolidated financial statements.

That concludes my commentary. Thank you for listening. Operator, we can open the call to questions from the analyst community when you are ready.

Q&A

Operator

Thank you. At this time, if you would like to ask a question, please press *, followed by the number 1 on your telephone keypad.

Your first question comes from Walter Spracklin from RBC Capital Markets. Your line is open.

Walter Spracklin — RBC Capital Markets

Thanks very much. Good morning, everyone.

Joe Randell

Good morning, Walter.

Gary Osborne

Good morning.

Jolene Mahody — Executive Vice President and Chief Strategy Officer, Chorus Aviation Inc.

Morning.

Walter Spracklin

So looking at your portfolio yield here, it's trending up nicely now that we have the disclosure. And just curious as to whether, with this still being a kind of growing and early days on a relative basis early days portfolio, is this a yield that is likely to stay steady from the current trends? Or is it something that you expect as it matures goes up? Or would you see it moderate, just looking at directionally if right now is a good read on the go-forward or if we should adjust it going forward?

Gary Osborne

We see it as being stable.

Joe Randell

Yup. I agree.

Walter Spracklin

Okay. So the current run rate's a good proxy. Got it.

Gary Osborne

Yeah. Yeah.

Walter Spracklin

Okay. Next question just, Joe, just in terms of the climate for new deals.

Joe Randell

Mm-hmm.

Walter Spracklin

Obviously, a lot of disruption out there with respect to the grounding of the 737 MAX. Is that leading to or is that having any impact either way? And even barring that, if you could give us an update on whether you're seeing more activity, less activity, or fairly constant levels of activity compared to prior periods.

Joe Randell

Yeah. The grounding of the 737 MAX hasn't had any material impact on us whatsoever. As a partner of Air Canada and as a good partner, we do some extra flying. We've covered some extra flying wherever we could whenever they've asked us to. But that does not have an impact on the bottom line, given our new CPA with Air Canada. And we've not seen any material impact on demand on the leasing side because of the 737 MAX. I think everyone is hopeful that these issues will be resolved before too long.

On the industry in general, we're seeing a very good pipeline still of opportunities. We've got a number of opportunities that we're working on actively. So we see the momentum continuing. And we do know that as we approach early next year that we'll be looking at how we further grow and develop this business. We are starting to spin cash off the existing portfolio as well, which we will continue to reinvest in leasing.

But the demand is robust in the rest of the world, and we're very happy with the way things have been going and way we see things happening on the leasing side.

Walter Spracklin

Okay. Just a last question here, maybe one for Gary. The stock-based compensation moved quite significantly. And just looking at your share price, it seems to have been kind of held in and I understand it dipped in December and then back up. But I'm just curious as to how the calculation worked on that metric and so how we can model it going forward.

Gary Osborne

Yeah. So it's fair value accounted. So as the stock price moves, we have to look at the units behind it, units of stock. And basically, we multiply it by the change in share price, and that makes its way through the statement. So it's pretty much that simple. And it relates to all the stock-based compensation we have.

Walter Spracklin

Okay. Okay. Thank you very much.

Joe Randell

Thanks, Walter.

Operator

Your next question comes from Doug Taylor from Canaccord Genuity. Your line is open.

Doug Taylor — Canaccord Genuity

Thank you. Good morning.

Joe Randell

Hi, Doug.

Doug Taylor

You continue to outline your position as an operator, lessor, and an MRO and parts business as being a differentiator when it comes to leasing. We won't see the benefits until we see these leases begin to expire from some of that. So two questions. First, what's the shortest remaining lease term on any aircraft you have in your portfolio right now? And second, I mean have you priced any of these leases with what you'd say are differentiated assumptions of residual value based on the unique abilities you've got there?

Joe Randell

Well, we have just one lease expiring in 2020 is the earliest one on the third-party leasing side. I would say that, and I think I've mentioned, initially our focus has been on more newer assets along with the operators, et cetera because we've been growing this business very conservatively.

As now, we have a broader base on which to build, and I think we're able to open that aperture a little and look at midterm-like aircraft prices. And we actively are evaluating some opportunities in that area.

And with midlife aircraft and with certain operators, it gives us then more opportunities to look at and to benefit from the synergies on the MRO side because if you're looking at a part-out aircraft—sorry, a midlife aircraft and you've got a short lease on it and it's getting close to end of life, you can look at potentially parting it out, converting it, et cetera.

So up to now, we've not seen, really, any significant benefit across, other than it's sure providing us with introductions to a lot of different carriers and people that I think will be good for our business going forward. But as we broaden out the leasing portfolio, I think you'll see more of the realization of the benefits of the other aspects of our business.

Doug Taylor

And would you think that would manifest itself in you bidding, at least competitively, on the leasing portion of the return profile and then making, potentially, a better return on the part-out? Or would you price the leasing less, win more market share, and then recapture it on the part-out? Could you help me think about that?

Joe Randell

Yeah. I think it depends. It depends on because when you're bidding on leases, of course, you're in a competitive environment. And the first part of that is to get in the door with respect to leasing the airplanes, et cetera.

So we haven't been looking at how we're going to drive even more benefits. We've been focused, up to now, primarily, on just the lease itself, the economics of the lease, our comfort with the residential value, and not really putting any quantifiable benefit in for synergies.

For us, I think these are the bonuses that we would derive from the type of platform that we have.

Doug Taylor

Okay. As you mentioned, you've got 90 percent of the capital raised for leasing business deployed. And I know you get asked this every time, but could you update us on your thinking about the next phase of your growth in terms of the capital you'd like to raise? And then related to that the potential for managing third-party capital, any update on your thoughts there would be helpful.

Joe Randell

Sure. Well, I think the opportunity to manage third-party capital is clearly there. And it's an opportunity that we continue to look at. We still have some runway with the capital that we have on hand. As I mentioned earlier, we're generating some good cash flow from operations. We do now have a US$300 million warehouse facility. We've drawn on approximately 56 million against five aircraft in that facility.

So we're exploring many options, some that were not available to us in the past and are now available, potentially, due to the scale of our leasing operation. And so we're not going to grow for the sake of growth, it's got to be profitable. But we're maintaining the same guidance for now, but it is clearly a work in progress.

Doug Taylor

Thank you very much.

Joe Randell

Okay.

Operator

Again, if you would like to ask a question, please press *, followed by the number 1 on your telephone keypad.

Your next question comes from Cameron Doerksen from National Bank Financial. Your line is open.

Cameron Doerksen — National Bank Financial

Thank you. Yeah. Good morning.

Joe Randell

Cameron.

Cameron Doerksen

Just a couple questions. First just on the, I guess, the aircraft CapEx, that 428 million to 433 million expected for 2019. Just want to make sure that that number includes the SpiceJet five aircraft.

Gary Osborne

That is correct. Yeah.

Cameron Doerksen

Okay. Perfect. And just on that deal, the SpiceJet deal, this one sort of seems a little unusual versus other announcements you've made here, a bit of a quick turnaround the fact that you made an announcement and the aircraft are coming in in fairly short order. Just wondering if you can talk about how that materialized. I mean, maybe it was just the timing of when you actually put out a press release, but just is it something that sort of happened sort of short term or was this sort of a regular-type deal?

Joe Randell

No. We've been in discussions with SpiceJet for quite some time. And these aircraft were being delivered. And I know SpiceJet were looking at a number of different ways of going at this. And ultimately, of course, it wasn't until they were prepared to make a decision as to what they wanted to do and how they wanted to finance these aircraft that it came down to finalizing the deal.

In fact, with these aircraft, we're pretty well ready to be delivered. The good news for us, I think, is we're putting our capital to work more quickly, and we'll start generating benefits from that. And I think SpiceJet has been enjoying the benefits of a market in India that's been pretty disrupted as a result of the Jet Airways issues. And we're seeing other carriers really picking up the slack here, SpiceJet, Indigo, et cetera, and filling in the void because there's very, very heavy demand and a lot of growth in that market.

Cameron Doerksen

Okay. No. That's helpful. That's all I had. Thanks very much.

Operator

Your next question comes from David Ocampo from Cormark Securities. Your line is open.

David Ocampo — Cormark Securities

Good morning, and thank you for taking my questions. First one here is on the CPA. Are you performing in line with your expectations of not trending above or below the maximum annual variance?

Gary Osborne

No. We're trending exactly where we expect to be, so.

David Ocampo

Okay. Perfect. And I was wondering if you can talk a little bit more about the part-out business, specifically what you're seeing in the market and if you see potential to go to more short-life assets?

Joe Randell

Yeah. We're very, very pleased with the way the part-out business has been going. We've parted out a number of our older aircraft. We have purchased two used Q400s that we've parted out. And we're seeing the returns being very good; good demand in the marketplace. And it's a relatively new business for us, but one that we're quite excited about. And we will probably have some of our other aircraft as they come out of the CPA that will be good candidates here as well.

So clearly, for us, it's very synergistic with the fleet that we have, and I think is a significant strategic advantage for us in terms of—and we can put our labour on this if we have excess time, et cetera, to use, et cetera. So it's got a lot of benefits in terms of our business.

David Ocampo

Perfect. Thank you.

Operator

Again, if you would like to ask a question, please press *, followed by the number 1 on your telephone keypad.

We have no further questions. I'll turn the call back over to the presenters.

Nathalie Megann

Thank you, Operator. We will now conclude the call, and thank you for joining us this morning.

Operator

This concludes today's conference call. You may now disconnect.