FINAL TRANSCRIPT

Chorus Aviation Inc.

Third Quarter Results Conference Call

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PRESENTATION

Operator

Good day. My name is Steve, and I'll be your conference Operator today. At this time, I would like to welcome everyone to the Chorus Aviation Inc. Third Quarter Results Conference Call. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there'll 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'd like to withdraw your question, please press the # key. Thank you.

Nathalie Megann, Vice President, Investor Relations, please go ahead.

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

Thank you, Steve. Hello, and thank you for joining us today for our third quarter 2018 conference call and audio webcast. With me today from Chorus are Joe Randell, President and Chief Executive Officer; and Jolene Mahody, Executive Vice President and Chief Financial Officer.

We'll start by giving a brief overview of the results, and then go on to questions in 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 are subject to various risks, uncertainties, and assumptions that are included or referenced on Page 38 of our Management's Discussion and Analysis of the results and operations of Chorus Aviation for the period ended September 30, 2018, the Outlook section, and other sections of our MD&A in which such statements appear.

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

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

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

Thank you, Nathalie, and good morning, everyone. Thank you for joining us.

In the third quarter, we generated over 87 million in adjusted EBITDA, up 3.4 million, or 4 percent over the same period last year.

Adjusted EBITDA came in below our expectations, due to added CPA costs related to increased component repair maintenance, primarily on the classic Dash 8 fleet, and CPA on-time performance challenges.

Historically, the third quarter is the most challenging from an operations perspective, due to high passenger demand, weather, construction, tight flight schedules, and congested airports. This makes it difficult to turn aircraft quickly, causing flight delays that persist throughout the day due to the inability to recover operations effectively.

Rate performance varies from quarter to quarter, depending upon a number of changing operational factors. From a year-to-date perspective, our rate performance on controllable costs is consistent with the same period of 2017.

While progress in completing leasing transactions slowed in the second and third quarter, we regained momentum with the recent announcement of several multi-aircraft transaction agreements, and have grown our fleet of leased aircraft to 80.

The fourth quarter will start to reflect additional lease income associated with these aircraft placements, while others will start to generate profits in 2019 as the lease arrangements take effect.

We are very pleased to welcome Philippines Airlines, the Lion Air Group, and Jambojet airlines to our expanding customer portfolio of leading regional operators. These mark our first transactions in Southeast Asia, a market we believe has good potential for future aircraft placements.

Once these recently announced transactions are completed, we will have acquired aircraft valued at approximately 730 million US to date, excluding the CPA aircraft, and secured additional long-term lease revenue streams, with average lease rate terms of approximately eight years.

To date, we have commitments for placing 33 aircraft with 12 customers operating in 12 countries on six continents. We are regularly engaging with current and prospective customers on new opportunities, and remain confident in the growth prospects of our leasing business.

That said, we are not wavering from our conservative and prudent approach to building this business, and will not grow for the sake of growth. As I've said before, this growth is going to be lumpy, and some transactions will take longer to finalize than others.

Given the breadth of our experience and capabilities in regional aviation, we remain confident the balance of this capital will be committed by mid-2019.

The addition of Q400 spare parts to our supply chain sales inventory is another step in this direction. This is our first part-out of an in-production aircraft and is an aircraft type, of course, that is highly utilized around the world.

Our ability to provide this service to operators is a synergy we can leverage with our lessees. This, in addition with our ability to now conduct heavy maintenance on Embraer 135 and 145 series regional jets expands our range of services.

In the quarter, we also secured a new contract with airBaltic of Latvia to conduct airframe heavy maintenance on 12 Q400s. The first aircraft has been completed and the second is now in the hangar.

Our extended service program on Dash 8–300s is progressing as scheduled with the completion of two more since our last report out, bringing the total to date now generating leasing revenue under the CPA.

We have extensive experience in managing every facet of an aircraft's life, from origination to disassembly and part-out and every stage in between. This is where our strengths differentiate us from our competitors.

I'd like to take this opportunity to congratulate our Jazz employees for being recognized again this year for outstanding achievement in employment equity and receiving the sector distinction award from Employment and Social Development Canada. Jazz also received the silver award in the transportation category of Canada's safest employers.

There's been a great deal of productive activity and solid milestones achieved. I sincerely commend and thank the Chorus team for their hard work and dedication to our vision.

I'll now turn the call over to Jolene, and she will take you through the financial results. Thank you.

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

Thanks, Joe, and good morning, everyone. In the quarter, we generated total revenue of 367 million versus 344 million in the same period of 2017, an increase of 23 million, or 7 percent. Adjusted EBITDA came in at 87 million, an increase of $3.4 million over third quarter of 2017.

There were a few onetime adjustments impacting our financial performance this quarter relative to the third quarter 2017. They are detailed in our disclosure documents, but here's a quick summary of what transpired.

We had a 1.5 million reduction in the other costs category in the third quarter of 2017 for a contingent consideration payable, we had a 1.2 million adjustment to our supplemental defined benefit pension plan occurring in this quarter, and we also had a change in tax rate for the first nine months of 2017 that had the effect of increasing adjusted net income in the third quarter of last year by 12.6 million.

When the first two items I mentioned are—when the first two items I mentioned are removed—sorry, when the first two items are removed, third quarter 2018 adjusted EBITDA was up 6.1 million over the same period last year. This was due to an 8.6 increase related to the growth in third-party regional aircraft leasing and increased aircraft leasing earnings under the CPA of 2.5 million, offset by increased CPA costs of 5 million, which resulted from increased component repair costs of 3 million, primarily on the classic Dash 8 fleet, and 2 million in additional costs associated with CPA on-time performance challenges.

Adjusted net income was 31 million for the quarter, a decrease from 2017 of 18 million, mainly because of the change in tax rates I mentioned earlier and foreign exchange losses on debt and working capital, which amounted to 3.3 million.

When you exclude these two items, adjusted net income declined by 2 million quarter over quarter due to an additional 2.8 million in depreciation primarily related to new aircraft and an increase in interest costs of 2.4 million related to additional aircraft debt, offset by the 3.4 million increase in adjusted EBITDA previously described.

Net income was 43.7 million for the period, a decrease of 35.6 million, or 45 percent from the same period of 2017. The decrease was primarily due to a quarter-over-quarter change in foreign exchange of 17.1 million related to unrealized losses on US-denominated debt, the previously noted 18 million decrease in the adjusted net income, and also increased employee separation program costs of 0.5 million.

Looking ahead to the balance of this year, capital expenditures for 2018, excluding those for the acquisition of aircraft and the ESP and including capitalized major maintenance overhauls, are expected to be between 41 million and 48 million. Capital expenditures for ESP and aircraft acquisitions are expected to be between 217 million and 220 million in 2018. This does not include capital for future to be announced aircraft acquisitions.

Based on scheduling information from Air Canada, Billable Block Hours for 2018 are expected to be between 364,000 and 370,000 hours, and this is based on 116 covered aircraft as at December 31, 2018. The actual number of Billable Block Hours for 2018 may vary from this anticipated range due to a number of factors, and you can see Section 10, Risk Factors in our disclosure.

For additional information supporting our projected guidance for the balance of this year, I’ll refer you to Section 4, the 2018 Outlook section of our MD&A for the period ended September 30, 2018.

We are very near to being able to roll out segmented earnings to the market. We are finalizing internal procedures, and plan to provide a comprehensive information package to help the market understand our new method of reporting very soon. We will issue an advisory with conference call details and directions to download the information.

And this concludes my commentary. Thank you for listening.

And, Operator, we can now open the call to questions from the analyst community.

Q&A

Operator

At this time, I would like to remind everyone in order to ask a question, press *, then the number 1 on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

And your first question comes from Cameron Doerksen with National Bank Financial. Please go ahead.

Cameron Doerksen — National Bank Financial

Yeah. Thanks very much. Good morning. Just a couple questions for me. I'm just wondering if you can … you talked a bit about the on-time performance in Q3 is always a more challenging period. Is there anything as we look ahead kind of to next summer where you potentially would say it's the same kind of tight scheduling that you would do differently, or anything you're sort of expecting that you might fix as we look ahead to next year?

Nathalie Megann

Yeah. Sure. I can speak to that. I think what we've seen, third quarter, as Joe indicated in his remarks, is our most challenging quarter for sure, given all the reasons he outlined. And much of that is, I think, outside of our control.

We can work to improve where we can, but I think when you look at the performance incentives and modelling kind of what the performance incentives are going to look like on a go-forward basis, given the tightness of the schedule, much higher utilization, high passenger loads, we're expecting from a performance incentive side probably to be in the range of achieving 60 to 65 percent of our available attainment kind of on a go-forward basis.

Cameron Doerksen

Okay. And just on the leasing business, we've had some, I guess, some news out of Bombardier last week just with regarding the divestiture of their Q400 program, and also there's probably some increased uncertainty over the CRJ program at Bombardier. I'm just wondering if you could maybe comment on what you think the impact might be on the leasing market for those aircraft both today and maybe in the future? And whether you see there's any potential impact on the values of the aircraft that you're operating?

Joe Randell

Yeah. That's something that we're certainly looking at and considering here, Cameron. And it is very early in the transaction, so it's early to tell what the impact of this may be. From what we understand, Longview is taking a business as usual approach, and committed to a seamless transition with no interruption in the production schedule out to, I think, 2021.

And Longview has had a successful track record of revitalizing the market demand for legacy aircraft, such as the Twin Otter and the Canadair water bomber series. And there may be potential for the Dash 8 aircraft production as well here. And I think Longview have certain advantages in the marketplace in terms of their overhead levels and the focus that they can provide on that type of equipment. So I don’t think it’s necessarily at all bad news.

I think Bombardier obviously has had some struggles with the Q400 program, et cetera. And we really believe in the asset itself and its potential and its application and the fact that the aircraft is very much a niche airplane in-marketplace.

So like I said, it is really early on and we’re watching it closely, as we are with the CRJ program as well because these are very important assets that are unique. And we see these assets, a demand for them, continuing. So steady as it goes. We’ve not seen any violent reaction in the marketplace from operators or lessors that I’ve seen so far.

And I think as Longview takes hold here of the program and looks to relocate some aspects of the program, I believe that they will make some progress with respect to reducing the costs associated with the Q400. And the costs have been, I think, an issue here.

So I think there’s an opportunity to address it and to make the asset stronger, even in the marketplace. But like I said, it’s really too early to tell at this point.

Cameron Doerksen

Okay. Very good. Thanks very much.

Joe Randell

Yeah.

Operator

And your next question comes from Doug Taylor from Canaccord Genuity. Please go ahead.

Doug Taylor — Canaccord Genuity

Yeah. Thank you. Good morning. I think we've all seen the deployment of capital and assets pick up of late, as you mentioned. Anything to point to about what made these transactions more attractive or get them across the line? Was there any change or movement in the market or pricing that contributed to the reacceleration of capital commitments?

Joe Randell

No. Other than these were commitments that, I think, we couldn't refer to by name in past quarters as being term sheets and close to being arranged. But each of these is its own negotiation, and delivery time frames vary as well. And quite often what really drives the finalization of the deals is if the delivery of the aircraft is going to be very … is imminent. And I think that's what we've seen here because these airplanes, the early ones, are being delivered sort of as we speak.

So on sale and leasebacks like this, that's the nature of the transaction, whereas of course a portfolio transaction is a little different in terms of buying the assets from another lessor. So nothing unique. We still see the market in the same way as we have with respect to the opportunities that are out there.

There's certainly with the world economy and various currencies some volatility with that. We're watching that very closely as well, but it's, I think we've said, it's going to be a little lumpy, Doug. And we can anticipate that, but overall the business is, I think, conducting itself as we have expected.

Doug Taylor

Okay. And then is it fair to say that given the outlook you just provided and the current debt market and the returns on equity you're achieving, at least modeling on the assets that you're bringing into your portfolio here still hitting I think we talked about a mid-teens kind of hurdle that you'd originally targeted—

Jolene Mahody

Yeah.

Joe Randell

We've not changed any of our targets, and we're not making any adjustments in terms of our expectations. We're still very much focused on what we'd said before.

Doug Taylor

Okay. You mentioned several positive announcements related to the MRO operation.

Joe Randell

Mm-hmm.

Doug Taylor

Can you just remind us if whether there's a capacity for meaningful revenue expansion there with the existing infrastructure you have? Or should we look at some of these announcements as more extending and diversifying the current revenue profile for that business?

Jolene Mahody

Yeah. I think you're right. Some of those are more an extension of the current profile. I think where we see our kind of more significant—and that's all relative—but our larger growth opportunity on the MRO side is in the parts business, so that would be incremental. But the contracts that we have here in Halifax for airframe, some of those that we had last year came to an end and we've replaced that with the airBaltic, expanding our capabilities certainly to Embraer. But it's more of extension on a go-forward basis than a real lift.

As far as trying to kind of get a sense of what it looks like, I'd say from an overall perspective we're likely looking at would be fair to say 10 to 12 percent growth on that line on a revenue basis.

Doug Taylor

That's very helpful. Thank you. I'll pass the line.

Joe Randell

Mm-hmm.

Operator

Your next question comes from Kevin Chiang with CIBC. Please go ahead.

Kevin Chiang — CIBC

Hi. Thanks for taking my question. Maybe just going back to your leasing growth opportunity, when you look to mid-2019, which isn't too far away and you're still committed to having the current capital you've raised deployed, how should we think about the next phase of growth here? Do you need to raise additional capital to grow the fleet beyond what you'll deploy by 2019 or mid-2019? Or will the internally generated free cash flow be enough to support continued investment into your lease portfolio here?

Nathalie Megann

Yeah. I mean, we—firstly I guess I'd say the additional funds that we have we see being committed by mid next year, as you said. We do have some of those deliveries that are taking place later on, already announced deliveries taking place later on in the back half of next year. But as to kind of future capital raises, it kind of remains to be seen at this stage how we go about the growth with the business. You're right that we are generating added cash flow kind of with the current business and with the new leasing business will in itself generate added cash flow that we can deploy into leasing.

So I would say we're still to be determined, I guess, with respect to how we grow after we spend this current raise. But you're right, Kevin, there is internal generation there that is spinning off and we intend to deploy into growing the leasing business.

Kevin Chiang

And correct me if I'm wrong, I think some of—in the early years or months of Chorus Aviation Capital, your ability to, I guess, get into a data room or to speak with potential sellers or airlines was maybe impacted by the lack of initial capital. And I guess you hadn't built out the reputation you've built out now. Given where you sit today, is that still an impediment in the sense that do you need to have the capital in place ahead of time before having these negations moving forward? Or are you big enough today that you can effectively have transactions lined up and then determine your funding method post these deals getting further down the line?

Joe Randell

Well, as you grow the business you obviously get a lot more traction in the market. And we're seeing that in terms of the opportunities that are there and some of the portfolio acquisition opportunities we have, et cetera. And as we move forward we look at our different financing options, including a lot of leasing companies use warehouses and things of that nature.

So the flexibility that we will have going forward in terms of making commitments I think will be greater as time goes on and as we mature. And so I think we're in a far better place than where we started out.

And as well, a lot of the banks, and especially European banks and others we've been talking to are very familiar with this segment and this industry, the leasing industry. We've had a lot of really good discussions there. And so we're making progress in a lot of areas.

So I think we are going to have more flexibility. I think that our aperture will increase as time goes on.

But as Jolene said, in terms of raising capital in terms on the equity that we put in this business, it's always under consideration in terms of what we do. And there are a lot of considerations for it in terms of our debt levels, the price of our customer equity, et cetera. So it's really a work-in-progress.

But I think generally certainly more opportunities more known, more flexibility than we had in the initial time period.

Kevin Chiang

That's excellent. And just a clarification question for me and last one is I think you said 60 to 65 percent available attainment of the performance fees, Jolene. Were you talking about specifically just in the third quarter, given the challenges? Or is that something we should be contemplating for full year?

Jolene Mahody

Yeah. I think if you kind of looked at the trends this year, I think the third quarter was certainly not good for all the reasons we outlined. But if you look kind of overall how we've been performing on the performance incentives relative to past years, there were years there where we had a very high attainment rate, up in kind of the 80 percent-plus attainment, which as we move forward I don't believe that's kind of realistic for your modelling any longer, just given we're in a lot of higher-gauge equipment now than we were then and tighter schedules.

So I think somewhere in the 65 percent range is probably more realistic, not only for current quarter, but on a go-forward basis.

Joe Randell

Yeah. We had historically a fair bit of white space in the schedule for pickup if airplanes were late, et cetera. But in particular for the larger aircraft, and for instance for the CRJ900s, utilization is amongst the highest in the industry right now. So we're doing a lot of long-haul flying into the US for Air Canada into US hub airports, and that's having an impact as well.

And I think while that's been going well from a demand perspective and I think the performance generally has been good, it does stress the operation in terms of on-time performance.

Jolene Mahody

The other thing, Kevin, is just as a reminder we do have an employee incentive program in place, so a lot of those performance incentives do end up being paid out from an employee perspective. So as that goes down, the expense goes down as well. So it's not all kind of flow-through impact on a bottom-line basis at all.

Joe Randell

Right.

Kevin Chiang

Thank you very much.

Operator

Again, to ask a question, please press *, 1 on telephone keypad.

And your next question comes from David Tyerman with Cormark Securities Inc. Please go ahead.

David Tyerman — Cormark Securities

Yes. Good morning. So I want to pick up on your last point, Jolene, that I think is the important thing. So did the CPA on-time hit of 2 million actually have any bit of impact on Q2—or Q3?

Jolene Mahody

Mm-hmm. So the performance incentive hit actually was consistent with last year's performance incentives levels, right? So we didn't perform any better last year on the performance incentives than we did this year achieving kind of the same revenue level.

We did, as you know, have some additional CPA costs in the quarter related to aging … some aging aircraft and incremental component repair costs that we didn't expect, as well as with the operational challenge just kind of being at the level that they were, we did see incremental costs related to direct labour, mainly overtime-driven. Kind of when you get off schedule and you have crew and aircraft out of place, it drives overtime for more maintenance employees, drives overtime for crew, et cetera. So that was the big hit.

When we kind of look forward to Q4, I would say given we're on a year-to-date … on a year-to-date basis those CPA cost differentials wash even to last year. And when we look forward to Q4, we don't expect to see kind of any significant differences or any surprises. We believe we'll be at or better than last year's performance on the CPA cost rate side.

David Tyerman

Okay. So sorry, just wanted to clarify. Did you just say like all these things like the maintenance issue and the op challenges, the overtime et cetera, they're a wash relative to last year? So there's really not a profit hit year over year from this?

Jolene Mahody

Yeah. On a quarterly basis they are, but when you look at our year-to-date numbers, we're fairly consistent with last year 2017 year to date. So we would have had earlier benefits relative to rates in the earlier quarters of the year.

David Tyerman

Okay. So just to make sure I understand some wording, Q3 it was a hit, but Q1 and Q2 it might have been a benefit net-net over the first nine months; you're kind of on track?

Jolene Mahody

You got it. Yep.

David Tyerman

And perfect. And then Q4 you kind of expect more like last year?

Jolene Mahody

Yep.

David Tyerman

Okay. Okay. That's very helpful. Thank you. And then on the MRO, the 10 to 12 percent growth that you mentioned, is that in revenue EBITDA? And what are the bases on this? Like is this material? Or …

Jolene Mahody

So that's on revenue, and I would say overall not significant numbers. It goes into the other revenue line, as you know, on our P&L, right? So if you look at that other revenue line, it's split between we have MRO and third-party leasing in there.

David Tyerman

Yep.

Jolene Mahody

I'd say about two-thirds is third-party leasing and the remainder would be MRO. So if you want to use that for your base.

David Tyerman

Okay. Helpful. Okay. And then just going back to the question on the Q400 and over to Longview. Do you have any examples maybe, Joe, of other aircraft that they haven't obviously gone out of service yet, but where there's been a major change and what's that done to the values of the aircraft, maybe something like the BAe/RJ, or something like that?

Joe Randell

Well, in those situations generally the aircraft line was shut down—

David Tyerman

Yeah.

Joe Randell

—like in the case of the 146 or even Fokker airplanes—

David Tyerman

Yeah.

Joe Randell

—but I think the best example is probably Viking itself then it took the Twin Otter and continued to invest in the aircraft, upgraded the cockpit, and the aircraft's still in production today. And it first started production years and years ago, has a niche in the market, is still there, and they seem to have been successful in doing that. And hopeful that something like that will be replicated in this situation because as a product line it's a great product, but as well, each product line needs to have continued investment in terms of upgrades and looking at different markets, et cetera. And I think there's opportunities for Q400 with that.

I don't want to speak for Longview in terms of what they see here, but this is what we're hopeful of.

So we certainly while we're concerned and watching it closely, we're not really at this point feeling that it's going to have a significant impact one way or the other. It's really too early to tell.

David Tyerman

Okay. Good. And then last question for me, just going back to the normalized results. So can you provide any insight into what normalized Q3 would be like? And I guess maybe related, is the first nine-months figure a normalized number for both years? Like does that give us an idea of what the run rate should be?

Jolene Mahody

So you—I think we've laid it out pretty well in kind of our disclosure with respect to onetime adjustments and then the CPA differences. So we had a $5 million difference related to the CPA cost that I just outlined, and we would have had a $1.2 million onetime adjustment related to a pension expense.

David Tyerman

Yeah.

Jolene Mahody

And our 2017 Q3 results would have been … the adjusted EBITDA level would have been $1.2 million higher than expected because of a contingent consideration payable amount.

David Tyerman

Right.

Jolene Mahody

So what's that? Like almost 8 million, almost $8 million. Does that help?

David Tyerman

Yeah, yeah. No, that's fine. So if I take those into account that gives me the normalized kind of—

Jolene Mahody

Mm-hmm. Yep.

David Tyerman

Okay. Very good. Thank you.

Jolene Mahody

You're welcome.

Operator

Again, to ask a question, please press *, 1 on your telephone keypad.

And there are no further questions at this time. I will turn the call back over to the presenters.

Nathalie Megann

Thank you very much, Steve, and thank you, all, for dialling in today.

Operator

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

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