FINAL TRANSCRIPT

Chorus Aviation Inc.

Second Quarter 2019 Earnings Analyst Conference Call

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PRESENTATION

Operator

Good morning. My name is Denise, and I'll be your conference Operator today. At this time, I'd like to welcome everyone to the Chorus Aviation Inc. Second Quarter 2019 Earnings Analyst Conference 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'd 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, press the # key. Thank you.

Nathalie Megann, Vice President of Investor Relations and Corporate Affairs, you may begin your conference.

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

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

We apologize, as we had some technical difficulties posting our MD&A and financial statements to SEDAR. However, that has been rectified, and the documents are also available now on our website.

With me today from Chorus are Joe Randell, President and Chief Executive Officer; and Gary Osborne, Chief Financial Officer. We'll start by giving a brief overview from 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 are subject to various risks, uncertainties, and assumptions that are included or referenced on Page 50 of our Management's

Discussion and Analysis of the results and operations of Chorus Aviation Inc. for the period ended June 30, 2019; the Outlook section; and other sections of our MD&A where such statements appear.

In addition, some of the following discussion involve certain non-GAAP financial measures, including references to EBITDA, adjusted EBITDA, adjusted EBT, 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. I'm pleased with our progress in the second quarter and how this year is progressing as we continue to make significant advancements in transforming Chorus into an international player in regional aviation. My comments will be brief and focused on our leasing business, given our stable and predictable operations under the CPA and at Voyageur.

In the second quarter, our group of companies delivered net earnings per basic share of $0.25, inclusive of an unrealized foreign exchange gain of $16 million on net income of just under 40 million. On an adjusted basis, net income reduced by 4.9 million to 24 million, or $0.19 per basic share.

As I mentioned, I'm pleased with our performance, and particularly with the traction we're gaining in the regional aircraft leasing space, having announced commitments on 11 additional aircraft in the period.

Since the launch of Chorus Aviation Capital in early 2017, we have built our portfolio to an impressive 56 aircraft, 13 of which we expect we'll deliver in the third quarter and two in the fourth quarter. When combined with the aircraft lease commitments under the CPA, our fleet of leased aircraft reaches a value of over US$2 billion with US$2 billion also in future contracted dry and wet lease revenue.

This solid growth trajectory has led to a very strong portfolio of brand-name carriers with aircraft type and geographic diversity, and we continue to deliver on our growth strategy, having fully committed our leasing growth capital almost a year in advance of our mid-2020 target. This is a significant milestone and a strong indicator of the opportunities that exist in this sector.

We're not changing our strategy of conservatively and profitably building scale in this business. We have several options available to us for growth capital, some of which were not available to us before now. And we're committed to ensuring additional value creation to our shareholders. Gary will share more insight on this in his commentary.

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 derived from leasing, a combination of flying operations, also characterized as wet leases, and then third-party dry leases.

We take a process-driven, conservative approach to building our leasing business. Our objective is to maintain a diversified customer base with good prospects, seek geographic diversification, and limit aircraft type concentration. Due to the predictable nature of our contracted revenues, the quality of our customers, and our resilient market sector, we are well-positioned to seize new opportunities to profitably grow and diversify.

I extend my sincere thanks to the 5,200 Chorus employees whose hard work contributed to another solid quarter.

Thank you. And I'll now pass the line over to Gary to take you through the second quarter financial 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 second quarter, and our financial results came in as anticipated. Here's how the quarter compares to the same period last year.

We reported adjusted EBITDA of 85.7 million, an increase of 1.6 million, or 1.9 percent, relative to the second quarter of 2018. The Regional Aircraft Leasing segment's adjusted EBITDA increased by 10.4 million due to the growth in aircraft earning leasing revenue. The Regional Aviation Services segment adjusted EBITDA decreased 8.8 million, offsetting the previously increase.

These results were expected, as they reflect the 2019 amendments to the CPA, which reduced the fixed margin and performance incentive revenue when we moved to market-based compensation rates earlier this year. These reductions were partially offset by the implementation of the controllable cost guardrail that mitigated the expected second quarter CPA margin shortfall related to reduced fees.

Beyond these changes related to the amended CPA, the second quarter results were impacted by increased stock-based compensation of 3.5 million due to the strengthening of the share price, offset by increased aircraft leasing under the CPA and increased capitalization of major maintenance overhauls on owned CPA aircraft over the previous period.

Adjusted net income was 24.7 million for the quarter, a decrease from 2018 of 4.9 million, or 16.5 percent, due to an increase in depreciation of 4.2 million, primarily related to additional aircraft in the Regional Aircraft Leasing segment; an increase in interest costs of 4.5 million, primarily related to additional aircraft debt including financing of $95 million related to the acquisition of six aircraft previously acquired with cash, as well as standby fees on the revolving warehouse facility in the Regional Aircraft Leasing segment; and an increase of other costs of 2.2 million related to foreign exchange losses on working capital, offset by a gain on disposal of property and equipment, again offset by 1.6 million increase in adjusted EBITDA previously described, and a 4.4 million decrease in income tax expense related to lower adjusted EBT.

Net income was 38.9 million, an increase of 22.6 million over the 2018 period. The increase was primarily due to the quarter-over-quarter change in unrealized foreign exchange gains on long-term debt of 28.7 million, offset by the previously noted 4.9 million decrease in adjusted net income and increased employee separation costs of 1.2 million.

As Joe mentioned, the growth capital we have on hand has been fully committed. We're very pleased with that and are maturing as a business. Since the launch of the business, we have grown the Regional Aircraft Leasing segment by an average of approximately 20 aircraft per year.

In the near term, we have the capacity to fund comparable organic growth in the leasing business through a combination of additional debt enabled by our repayments of our rapidly amortizing debt and internally generated cash flows.

Looking ahead to the balance of this year, capital expenditures for 2019, excluding those for the acquisition of aircraft and the ESP and including capitalized major maintenance overhauls, are expected to be between 34 million and 40 million. Capital expenditures for ESP 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've changed our schedule of planned ESPs to align with the CPA amendments and, as such, we anticipate conducting four ESPs this year, five in 2020, with the balance completed before the end of 2022.

As a result of the CPA amendments and the fixed fees, we'll no longer provide the number of departures or Block Hours starting with our third quarter report-out, as they are no longer relevant to our earnings.

For additional information supporting our projected guidance for the balance of this year, I'll refer you to Section 4 of the 2019 Outlook section of our MD&A for the period ended June 30, 2019.

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

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

Your first question comes from Doug Taylor with Cannacord Genuity. Your line is open.

Doug Taylor — Canaccord Genuity

Yes. Thank you. Good morning. I'd just like to dig in a little bit into your comments about comparable capital deployment with sort of, I guess I'll call it, organic capital sources being internally generated cash flow and how we should think about what you consider to be the excess capital available for reallocation to growing the leasing portfolio. Can you help us frame that up? And what you see as the available capacity currently?

Gary Osborne

I guess when you look at the cash flow statements and that on the debt, you can see that we're paying down our debt pretty rapidly. And when you look at the metrics of the leasing business and the

Regional Aviation Services business, there's leverage left that we can put back into the business. So on the debt side, you can look to the cash flow statement and then you can also look at what we're generating from the business there.

Doug Taylor

Okay. You continue to expect so a 3:1 debt-to-equity, between 3:1 to 4:1 on the incremental leases that you'd be adding. Is that a fair statement?

Gary Osborne

Yeah. Seventy-five percent loan-to-value would be what we would expect on the aircraft acquisition, and the capital we would raise that we've alluded to would help us fund the equity portion.

Doug Taylor

Right.

Joe Randell

So with that we should be able to continue to grow at the rate that we've been growing at since we launched the company.

Gary Osborne

Yeah.

Doug Taylor

And then on that statement, I mean, it's been an impressive growth profile for the Regional Aircraft Leasing business. It has been lumpy at times one year to the next. Should we use the current year's capital deployment as the benchmark for what you aspire to continue to deploy at or some sort of average of the previous couple years?

Gary Osborne

Well, I guess what we're saying is around 20 a year for next year. As far as the timing goes, you could smooth it out during the year, but that's yet to be determined.

Joe Randell

And that 20 is based on the same sort of unit price that we've been—

Doug Taylor

Mm-hmm.

Joe Randell

—buying these aircraft—

Gary Osborne

Yeah.

Joe Randell

—on up to now.

Gary Osborne

Yeah.

Doug Taylor

Okay. All right. Obviously interest rate projections have rolled over pretty hard for the broader economy, especially the US interest rate, which is important for leasing or aircraft. Can you talk about whether there's been any impact on the lease factors or the pricing out there at the kind of regional-class aircraft level?

Gary Osborne

Well as you know, on the lease rate factors there's always an adjustment for interest rates that gets factored in. So from that perspective, the lease rate factors have been moving with those. So we haven't seen really any impact on the margin that we're earning.

Doug Taylor

Understood. Okay. Last question for me. I mean, as we look into Q3 here, 13 aircraft entering the fleet, and the portfolio is obviously a pretty meaningful amount relative to the size of that portfolio. So I was hoping you could help us with kind of the weighting or the timing, if they're front- or back-end loaded to help us kind of dial in the Q3 expectations?

Gary Osborne

Yeah. I don't really have the exact timing by month, but I'd probably just average it out through the quarter.

Doug Taylor

Fair enough. Thanks. I'll pass the line.

Operator

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

Cameron Doerksen — National Bank Financial

Thanks. Good morning. Maybe you can just give us kind of an update on what you're seeing out there as far as opportunities. I mean, it sounds to me like we've got plenty of opportunities still for adding aircraft to the leasing fleet, but maybe if there was a larger transaction or portfolio transaction out there that would be when you might need some additional capital beyond kind of internal sources. Maybe just talk about maybe opportunities you might see on sort of the larger transactions.

Joe Randell

Well, we continue to have a fairly robust pipeline and good customers in good jurisdictions, et cetera. We do look at portfolios, et cetera, but of course that would require, if it was very large, a different approach. But we're not anticipating that at this time.

But we are mindful of opportunities that may arise, but we are also mindful that any way that we finance this, or what we do is actually to the benefit of our shareholders and their earnings.

Cameron Doerksen

Okay. And I've been sort of interested in one of the more recent transactions you did with Flybe. These are, I guess, more midlife aircraft whereas previously you were largely targeting younger aircraft. I mean, I know it's not necessarily a change in strategy, but just maybe talk about your interest in maybe doing more midlife aircraft and how do the returns on those types of transactions compare with newer aircraft?

Joe Randell

Well, the returns are I'd say fairly comparable. We look at these assets a little differently in terms of their life. In the case of Flybe, that company has been successfully restructured and we feel has a good future in the marketplace now with a new ownership, et cetera.

With those airplanes, when we have midlife aircraft we also, aside from either selling the asset or re-leasing, we look at part-out possibilities as well, so I think it's quite reasonable for us to add that type of aircraft to our portfolio. It tends to balance it out, and so we're very pleased to look at midlife aircraft for that reason.

Cameron Doerksen

Okay. And maybe just last one for me. Just on the CRJ. I mean, obviously Bombardier, or I guess soon to be Mitsubishi is going to end production of that aircraft and you still have some additional CRJ-900s coming next year. I'm just maybe wondering what you think about from a value concern on that aircraft type. I mean, an out-of-production aircraft, is that more difficult to re-lease when some of those leases come up?

Joe Randell

Well, there have been there aircraft that have been discontinued in the past and they continue to—the production discontinued, continue to have a pretty good market. And Mitsubishi purchasing the program, they purchased the marketing and the product support, and I think that's critical to their success. And we expect the support for the in-service CRJs to continue during the transition, et cetera. And so it's fully supported by Mitsubishi, and I think that will be the case for decades in the future.

Their reputation as a manufacturer as they move into their own … the MRJs, I think, is critical. So we have six within CAC and they're all young aircraft on long-term leases in Europe, so we don't expect any disruption there. And of course, we have five CRJs under lease to Air Canada with nine more coming, but those are supported by very long-term leases, and very little of our value comes from the residual side. So our contracted leasing revenues for the CRJs is actually pretty healthy and long term. So we don't see any residual value risk for us, certainly in the near term at all.

And we see these aircraft as being continued to be deployed and are successful within the regional business, primarily in North America, but I think we're not at all panicked about the residual values at this time.

Cameron Doerksen

Okay. Great. Thanks very much.

Operator

Your next question comes from Konark Gupta with Scotiabank. Your line is open.

Konark Gupta — Scotiabank

Thanks, and good morning, everyone.

Joe Randell

Good morning.

Konark Gupta

Just wanted to ask you on the CapEx side first, so there was this … a CapEx increase of, I think, about $200 million. Is that all related to third-party leasing?

Gary Osborne

Yeah. On the growth CapEx, yeah, it's third-party leasing.

Konark Gupta

Perfect. Thanks. And as the CAC becomes the key player in the market with a growing portfolio, are your customers still focusing on the same aircraft types that you're leasing right now? Or is there kind of an ask, maybe not a demand, but like there's maybe a discussion about more aircraft types?

Joe Randell

Well, I think we've said before that we are generally within the Regional Leasing segment 75 seats and greater. I think we've commented that the A220 is an aircraft which is interesting to us. It is to be operated, we believe, in both the regional and mainline environments, so it's an aircraft that straddles both segments. But I think there are opportunities there.

And, of course, with the Embraer product now with the E2s, which is the next generation of Embraers, those aircraft are interesting to us as well. We are very triple-prop-oriented up to this point, which we're quite happy about, with no real technological obsolescence and great residual values and good demand for these aircraft because of their unique capabilities.

So we're fairly broad. We are not at all heavily exposed with respect to the Embraer classics or the CRJs, as I mentioned, but so they're all really within our scope.

Konark Gupta

Okay. No, that's great colour. And then lastly for me, on the leasing portfolio you said you have about 56 commitments now. So in terms of the contracts there in terms of the length and terms and the aircraft that you expect to come back to you over the number of years, what do you see the replacement cycle to look like for the aircraft? Because some of these aircraft are obviously slightly older than you would typically want, right?

Joe Randell

Yeah. Most of these airplanes are still on very long-term leases, and we have few aircraft coming back in the near term and the ones that are, we continue to be engaged on that. So we're very optimistic that the number of aircraft that we would have sitting on the ground and not deployed would be very little, if any.

Konark Gupta

Okay. And that's it for me. Thank you so much.

Operator

Your next question comes from Tim James with TD Securities. Your line is open.

Tim James — TD Securities

Thank you. Good morning. I just want to return to Doug's question earlier. Am I correct in interpreting your answer to mean that you expect to generate total free cash flow after dividend payments that's approximately equal to the equity that's required to buy about 20 aircraft per year at a 75 percent loan-to-value ratio?

Gary Osborne

No. No, that's not what we're saying. What we're saying is between a combination of acquiring new debt and the cash flows from the operations that we can continue to grow.

Tim James

At 20 aircraft per year?

Gary Osborne

Yeah. Well, in the near term.

Tim James

Okay. Yeah. Sorry, maybe I didn't word it properly. That's exactly what I was asking. That's helpful. Thank you.

And then maybe you could just talk about sort of your long-term aspirations for the leasing business in terms of the global market size being a top player in the industry. I'm just thinking kind of longer term what's driving your thoughts.

Joe Randell

Yeah. Well, we're still quite bullish on the segment, and believe that we have developed a very good niche within the market. And we're seeing growth in general in regional aircraft even in the turboprop side, for instance, with the ATR 72, et cetera. So I think we've become a fairly significant player in the market, already close to being number two in the world, but still a very small part of the overall regional aircraft portfolio out there.

So a lot of growth opportunity, but for us we're approaching it cautiously in a measured way and at a rate that will make sense for our shareholders. And that's the approach that we're taking. But the good news is a lot of opportunity there, and that's what we're looking to exploit. And we've gotten to this place in the last two-and-a-half years, and I think we're well known in the business now. And most proposals that regional carriers look for and manufacturers, et cetera, we're on the list.

Tim James

Okay. Great.

Gary Osborne

Sorry, it's Gary here. Just to clarify and make sure we're clear on the debt piece. So the debt and the cash generation would fund the equity portion of the investment into the aircraft, and then we would still continue to do the loan-to-value of 75 percent or thereabouts on any acquisition, just to be clear.

Tim James

Right. So maybe a simpler way I should have asked the question is, you expect to generate the equity going forward that will allow you to grow at approximately 20 aircraft per year without requiring external equity. Is that correct?

Gary Osborne

Yeah. We don't require external equity. We see—

Tim James

Right.

Gary Osborne

—in the near term, the next year, that we can put more debt onto the balance sheet and then through the internal cash generation fund up to 20 aircraft a year.

Tim James

Right. Okay. Great.

Joe Randell

And external equity is not required to grow at that rate.

Tim James

Yes. Perfect. Thank you very much.

Operator

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

Your next question comes from Kevin Chiang with CIBC. Your line is open.

Kevin Chiang — CIBC

Hi. Good morning, and thanks for taking my question here. Maybe just also to follow on Doug's earlier question around the lower interest rate environment. Maybe if I were to ask a different way, there's a lot of cheap capital out there. I guess there's probably a decline in some of that capital working its way through the narrow-body market, given what's happened to the MAX. So just wondering, when you look at the competitive environment, while you're not seeing any margin compression, are you seeing more competitors when you're bidding on potential leasing opportunities? Or has the number of competitors stayed generally static the past, let's say, six to nine months here?

Joe Randell

Yeah. I don't think we've seen a particular increase in the number of competitors. It is competitive. We do bid against a number of others each time, et cetera, but we've not seen any significant influx at this point.

So I think a lot of the larger lessors continue to focus on the narrow-body and wide-body aircraft, and of course I think they're pretty focused on the MAX these days and very busy with Airbus product, so.

Kevin Chiang

That's helpful. And then when you look at your positioning, and I appreciate the comment around you're the second-biggest player, but it's still quite a distance between you and the number one player. Like when you look at the total available market for you, is there a sense of how big this is? It feels like it's a lot bigger than you originally anticipated, say, three years ago. Is there a finite size to this market that you get to that at some point in time you start looking at other aircraft types? Or it just kind of hits a glass ceiling and that's as big as you're going to be and you just kind of churn through the portfolio at that point in time? Is there a sense of when you get to that point?

Joe Randell

I think in the narrow-body side, for instance, roughly 50 percent of the world's fleet is leased. Under the regional side today, it's probably 20, 25 percent. And we see no reason as to why the regional fleet should not achieve the same level of penetration.

And we—right now we're small, but we've grown to this point in two-and-a-half years, and just to compare ourselves to the largest player in the market, they're I guess a little over 3 times our size at this point. So we're almost a third of that largest player that's in the business for quite some time.

So we've been growing very quickly, but still there are most of the proposals that we look at we do not go forward with, so ample supply of opportunity.

Kevin Chiang

Okay. And maybe just last one for me. You’ve talked about having this diverse portfolio of aircraft and partners in terms of where the airlines are geographically positioned. When you look at things now, you have a lot of stuff in kind of the Asia-Pacific region, Europe, maybe less in North America and South America. Do you think of things that way? Do you think of your portfolio and say we should over-index more now a little bit over the next year into North America where we might have less exposure? Or is that not how you look at it?

Joe Randell

Well, I guess you could say that we are significantly in North America, given the leases that we have with Air Canada.

Kevin Chiang

With Air Canada, okay.

Joe Randell

We're in Mexico, et cetera. And the growth in the business has largely been and the demand for new airplanes, in particular, has largely been in Asia. And of course, we are in Africa as well, but in these jurisdictions generally we lease to the strongest operators in these jurisdictions, and so that's been our approach up to now in terms of being very selective.

We are in South America as well, and the economies in South America are generally doing—well, not all economies. I guess Brazil is doing better. And so we continue to look outside.

In North America, generally a lot of the regional airplanes are leased, are owned by the mainline carriers, and that creates a very competitive environment with respect to lease rate factors, et cetera. So for us it's about balancing off the risk and the returns. We'll continue to explore opportunities in North America. And we're also now in Europe in a significant way with a number of carriers, so it's all about balance. It's all about having a diversified portfolio.

Kevin Chiang

That's it for me, and congrats on a solid quarter there.

Joe Randell

Thank you.

Gary Osborne

Thank you.

Operator

There are no further questions queued up at this time. I turn the call back over to Nathalie Megann.

Nathalie Megann

Thank you, Denise. And thank you, everyone, for being present on the call this morning. And we look forward to speaking with you again in the near future.

Have a great day.

Operator

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