Chorus Aviation Inc.

Second Quarter 2020 Earnings Conference Call

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CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Chorus Aviation Inc. Second Quarter 2020 Earnings Conference Call. At this time, all participants are in a listen-only mode.

After the speakers' presentation, there will be a question-and-answer session. To ask a question during this session, you'll need to press *, 1 on your telephone.

Please be advised that today's conference is being recorded.

If you require any further assistance, please press *, 0.

I would now like to turn the call over to Nathalie Megann, VP, Investor Relations. Please go ahead.

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

Thank you, Operator. Hello, and thank you for joining us today for our second quarter 2020 conference call and audio webcast. 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 of the results and then discuss the impact of COVID-19 to our business, 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 in our Management Discussion and Analysis of the results and operations of Chorus Aviation Inc. for the period ended July 30, 2020, 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 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. Given the state of the global airline industry, our results and continued profitability demonstrate the resilience of our business.

Aviation around the world continues to be challenged by the effects of the COVID-19 pandemic. Our focus remains on ensuring the safety of our employees and passengers and maintaining ample liquidity.

We are doing everything in our power to secure our future for when this crisis pasts. We've dramatically reduced costs, curtailed capital investment, and raised new funding.

We now have approximately $228 million in liquidity, and we are well positioned to manage through an extended recovery period and to resume our growth plans when the time and conditions are right.

This pandemic and the resulting provincial and federal government-imposed travel restrictions and border closures are having a devastating effect on passenger travel demand. And as time goes on, it will be increasingly more difficult for our industry to recover.

Our Air Canada Express operation is a fraction of what it was this time last year. To put this into perspective, in the second quarter of 2019 we operated over 56,000 flights and carried 2.7 million passengers under the CPA compared to just 5,000 flights, or 92,000 people this past quarter. We've reduced our workforce by over 65 percent, and I sincerely hope more employee reductions won't be necessary.

The Canadian government needs to look to other G20 countries that have implemented safe, thoughtful, practical, and science-based approaches to easing travel restrictions strategically in order to enable business and economies to restart and succeed within this new normal. Unlike other countries, Canada has not provided direct support to the aviation industry.

We continue to work closely with Air Canada on cost reductions, synergies, and the efficient deployment of the schedule. The situation is very fluid.

We are executing on our fleet modernization strategy, an important component of our cost-reduction initiatives. All of the Dash 8-100s have been retired and we are looking to repurpose them. We've taken delivery of three new CRJ900s, and six additional new aircraft are planned to be delivered later this year. The replacement of smaller and older aircraft by these larger, modern, and efficient aircraft is key as Air Canada endeavours to effectively match capacity and costs with travel demand.

At the end of the second quarter Air Canada announced the discontinuation of 21 regional routes operated by Jazz and the closure of eight Jazz-managed stations at regional airports. I understand the impact these service closures have on our employees, suppliers, and the affected communities, many of which have lost their only link to Canada's domestic and global air service networks.

These are unprecedented times, and I appreciate these decisions are very difficult to make.

Last week's federal announcement of new measures to support essential air services to remote communities is a first step in the right direction, but much more needs to be done. This new program is meant to assist our most remote communities, but it does not encompass smaller regional locations across

Canada that also need reliable air transportation. It does nothing to assist Canada's primary commercial airlines.

Canadian airlines are significant contributors to economic growth in Canada. Regional airlines are key to the provision of employment opportunities and are facilitators for travel and tourism, contributing to the overall economic growth of the smaller communities to which they fly. Without this service businesses, academia, and tourism operators will struggle.

In Canada, we have one of the highest levels of government-imposed costs in the world and in the current COVID-19 environment with one of the lowest levels of government support. As an example, we've recently learned that in response to this crisis, Nav Canada is increasing its charges to airlines by approximately 30 percent starting in September. This is not the kind of action this industry needs.

We need to work decisively and quickly to bring the thousands of aviation employees back to work. At Chorus, we're doing everything we can to bring our 3,200 employees back and we need government to do its part.

Now turning to Voyageur. Voyageur continues to provide overseas humanitarian flights and cargo services and the air ambulance operation in New Brunswick. Voyageur's MRO and part sales operations experienced lower demand during the quarter due to the impact of COVID-19. However, MRO services demand has subsequently increased, necessitating the return of employees previously on temporary layoff. This is an encouraging development, and we're pleased to welcome them back as we continue to pursue new business opportunities.

While the industry remains under significant stress, we are encouraged by some positive signs of a resurgence. As expected, regional aircraft have been affirmed as fundamentally important to most countries' domestic transportation networks, with regional aviation generally resuming flying earlier and in a quicker pace than long-haul travel.

With the improving traffic trends, we are seeing a greater increase in the utilization of regional aircraft compared to narrow- and wide-body aircraft.

Approximately 50 percent of our third-party leased fleet is flying, with the number of flight hours up from the low points of this past spring. Moreover, since demand remains weak, many carriers are now deploying lower trip cost regional jets in place of narrow-body aircraft on parts of their network.

During the second quarter, our Air Canada Express operation flew approximately 9 percent of the block hours flown in the same period last year. We expect this to increase to between 20 percent and 30 percent for the balance of this year compared to 2019. We believe the CRJ900s will play a vital role in the recovery phase.

Overall, our portfolio of leased aircraft is holding up relatively well in the current environment. We have provided short-term rent reliefs to most of our lessees, and these deferrals are typically between 3 and 12 months with repayment over a subsequent period, usually between 12 and 24 months. Approximately 28 percent of lease revenue was collected in the second quarter and this subsequently increased to approximately 38 percent in July.

Given the geographic diversification of our leased portfolio, we expect to see a variation in the ramp-up speed and financial stability of these airlines. Our approach with customers is to work with them to our mutual benefit. Consistent with market norms, our leases are for a fixed term, contain absolute payment obligations on the part of the lessee, and cannot be terminated for convenience.

In today's environment, many airlines lack capital to fund new deliveries, creating new opportunities for sale leasebacks and the leasing of new deliveries. Several airlines are monetizing their unencumbered fleet through sale and leaseback transactions. We believe this could potentially become the dominant channel for financing new acquisitions by airlines. We'll look to take advantage of these as the economy improves.

We recognize the revitalization of the regional sector will be protracted, sporadic, and will extend well into 2021 and beyond. We are taking all reasonable measures to protect and preserve our company.

I extend my gratitude to all our employees who have done tremendous work to ensure we weather this crisis. Their continued commitment, resilience, and focus on safety have been unparalleled.

Thank you, and I'll pass the line over to Gary.

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

Thank you, Joe, and good morning. I echo Joe's sentiments on the resiliency and the strength of our employees. We truly have an incredible team, and I am confident we'll get through this period together.

Our second quarter adjusted EBITDA was $91 million, a $5.3 million increase over second quarter 2019. Adjusted net income was $21.6 million, a $2.5 million decrease over last year, which led to a decrease in adjusted EPS at $0.13 versus $0.15 last year.

Here's how the second quarter of the year compares to 2019. The regional aircraft leasing segment's adjusted EBITDA increased by $8.2 million, primarily related to the growth in aircraft earning leasing revenue, partially offset by a $1.1 million expected credit loss provision.

Due to the impact of COVID-19, the non-cash impairment charge of $9.5 million and $8 million for aircraft repossession costs were added back to adjusted EBITDA.

The Regional Aviation Services segment adjusted EBIITDA decreased by $2.9 million. The results were impacted by a reduction in other revenue due to a decrease in third-party maintenance repair and overhaul activity, lower aircraft part sales, and reduced contract flying of Voyageur due to the economic impact of COVID-19; decreased capitalization of major maintenance overhauls on owned aircraft operated under the CPA of $2.9 million; and expected credit loss and inventory provisions of $1.3 million in Voyageur, partially offset by decreased stock-based compensation of $2.6 million, increased aircraft leasing under the CPA, and decreased general administrative expenses.

Adjusted net income was $21.6 million for the quarter, a decrease of $2.5 million due to an increase in depreciation of $5.9 million, primarily related to additional aircraft in the Regional Aircraft Leasing segment; an increase of net interest costs of $3.2 million, primarily related to the 5.75 percent debenture on our unsecured debentures, the unsecured revolving credit facility, and additional aircraft debt in the Regional Aircraft Leasing segment; a decrease of $1.8 million due to a loss of $0.4 million versus a gain of $1.4 million on disposal property and equipment, partially offset by a $5.3 million increase in adjusted EBITDA, as previously described; a $2.5 million decrease in income tax expense; and a decrease of $0.6 million in realized foreign exchange and unrealized foreign exchange losses on working capital.

Net income decreased $9.8 million due to the previously noted $2.5 million decrease in adjusted net income, $9.5 million on impairment provisions, and $8 million on lease repossession costs, offset by the change in net unrealized foreign exchange on long-term debt of $6.3 million, tax recovery on adjusted items of $2.5 million, and decreased employee separation costs of $1.4 million.

We ended the quarter with $189 million in liquidity. Subsequent to quarter-end, liquidity increased to $228 million due to the recent financings of two unencumbered aircraft, the sale of a Dash 8-300, and the completion of lessee rent deferral arrangements.

In terms of cash flow in the quarter, we generated $63.3 million from operations before changes in non-cash working capital balances, which was slightly down by $3.2 million versus the same period last year.

Our non-cash balances related to operations reduced our cash flow by $91.5 million, an increase of $82 million versus the same period last year. The primary drivers of the working capital draw relate to the increased receivables driven by the increase in Controllable Cost Guardrail, lease rent deferrals, and lower trade payables caused by the reductions in our CPA operations.

Given our CPA air operations are projected to improve to between 20 percent and 30 percent of last year and the fact that lessees are beginning to pay a higher percentage of their aircraft rent, we expect working capital to stabilize or improve.

As we look ahead, we have seen our rental revenue received in the Regional Aircraft Leasing division increase to 38 percent in July, and we expect this to continue to improve over the next quarters as travel restrictions ease and airlines are able to increase their revenue-generating capacity.

We have also executed on loan repayment deferrals with our largest lender, EDC. This allows us to defer our payments of principal and interest to the end of the year, providing us the ability to match our debt payments with lessee deferral arrangements and effectively avoid significant cash draws on the related loans.

Looking at our capital expenditure forecast, we see maintenance capital expenditures and heavy checks remaining within the previously planned range of $23 million to $29 million for the year. On the aircraft-related expenditures, we've added three additional A220 aircraft with airBaltic to our forecast for 2020.

We expect our capital expenditures to be financed through a combination of cash from operation and bilateral debt for the aircraft broker transactions in the Regional Aircraft Leasing segment. These deliveries remain subject to Chorus securing financing on acceptable terms.

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

Ladies and gentlemen, to ask a question, please press *, then the number 1 on your telephone keypad. To withdraw your question, press the # key. We'll pause for just a moment to compile the Q&A roster.

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

David Ocampo — Cormark Securities

Good morning, everyone.

Joe Randell

Good morning.

David Ocampo

I just wanted to circle back on sort of your future deliveries in your third-party leasing business. Is this a case where you're going to make deliveries and then subsequent after that the lessees are going to ask for deferrals? Or how are the discussions shaping up with your future deliveries?

Joe Randell

Well, the future deliveries, first of all, there are two airBaltics later this year that are subject to financing. airBaltic is operating a large part of its operation and is financially doing reasonably well. For sure the Latvian government has just provided a €250 million investment in the airline; very solid support from the Latvian government. And so we don't anticipate that at this time. And as I say, it's subject to financing and, of course, the financing and whoever we do the financing with will look to the financial strength of airBaltic at the time of delivery as well.

So that's our view at this time.

Gary Osborne

And, David, the way it works also, they have to be current on their rentals for us to—

Joe Randell

Right.

Gary Osborne

—give them delivery, so.

Joe Randell

And we have two aircraft with them now.

Gary Osborne

Yeah.

David Ocampo

And maybe you guys could talk a little bit about the repossession costs, what that entails and what you're seeing in the current leasing environment? Are rates down so significantly that you guys are going to have a hard time re-leasing out those around 16 planes that you may be getting back from administration?

Joe Randell

So the repossession costs that we had there, as you know, we had the Flybe event back in January/February fairly early on, and then COVID hit and, of course, that made securing the airplanes that were spread really over the UK, into Ireland, et cetera, challenging in order to get our people in there in order to get access to records and to actually ensure that the appropriate engines were matched up with the airplanes, et cetera. So certainly more complex and costly in a COVID environment. Certainly more complex and costly than normal.

We now have those aircraft secured. We are actively marketing those aircraft. It is a tough environment, there's no question about it. But we do not anticipate the depth of repossession costs on the other aircraft that are coming out just in the same manner in which we experienced with Flybe.

David Ocampo

That's great. And maybe shifting gears here to Air Canada. They're taking on the CRJ900; they took on three this quarter and another six at the end of the year. Is this the case that you guys are just going to fly those aircraft because it's more efficient and kind of taper off on the smaller aircraft? I know that was part of the plan originally. I don't know if that's just expedited under these circumstances.

Joe Randell

I think it's expedited under the circumstances. Air Canada desires to fly larger aircraft on some of these regional routes. And actually they are larger airplanes, but compared to narrow bodies they're not. And the regional jets, the CRJ900s right now, are deployed on a number of routes that are normally flown by Air Canada narrow-body aircraft. So they are certainly more economical on routes where you do not need the capacity. And of course, that exists on a number of markets in Canada right now.

David Ocampo

And last one for me here. How are the discussions with Air Canada? Is everything current? Are they asking for any sort of temporary relief? I know the fixed fee is small relative to the overall pie. Just trying to get a sense on that.

Joe Randell

Well, Air Canada's current and we have ongoing discussions with them. We are working closely with them. I think the pressure that Air Canada feels with respect to the marketplace, although it does not directly impact our bottom line, as time goes on there will be growing concern about the impact on regional routes and markets and when they come back. We've seen some route cancellations, but again the contract that we have with Air Canada is unaffected by that. But nevertheless, it is concerning to us because obviously we need to see that Air Canada is able to effectively deploy the fleet that we have and that there is good demand.

And that's why we are supportive of really ensuring that the government restrictions are really fact-based; that there is a desire to open things up more as other countries have done. And so we're watching that very closely. And we operate and are operating a number of flights now safely. And I've flown myself a number of times, and I can tell you the experience is different, but I certainly felt safe during the whole experience.

David Ocampo

That's great. Thanks.

Operator

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

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

Ralph Strata — RBC Capital Markets

Hi. It's Ralph Strata (phon) calling in for Walter Spracklin. Good morning, everyone.

Joe Randell

Good morning.

Gary Osborne

Good morning.

Ralph Strata

So I just wanted to touch quickly on the liquidity outlook that you mentioned in the MD&A. You noted that you expect it to be relatively constant in the second half. I just wanted to confirm, does that assume no additional financings need to be completed? And if there is a need for further financing, what avenues are you currently exploring to potentially bolster liquidity near term?

Gary Osborne

Yeah. So the only financing that's assumed in there is the aircraft-related as we take delivery. So all of our Aircraft Leasing segment's deliveries are subject to financing. So that's the only thing that's in there, so. And usually they're around 80 percent loan to value.

Other than that, we expect our liquidity to remain constant, or very good 'til the end of the year, in and around $200 million.

Ralph Strata

Okay. Okay. Awesome. That's helpful. And then just to working capital, assuming a significant headwind on cash in the quarter, but you see it stabilizing or improving in the back half. I just want to confirm that that is inclusive of the anticipated $60 million increase in receivables from regional leasing customers?

Gary Osborne

Yes. It includes everything we mentioned in the outlook. We also do expect our working capital to improve and particularly in the payables side. If you look at the operation in the first part of the year, it was around 10 percent or 12 percent of block hours flown in the first quarter. And we're going between 20 percent and 30 percent. That naturally just when you do aged payables and things like that helps the flow.

So we've already seen $5 million or $10 million pickup just since the end of June based on the increased volumes. So we expect good stability out of that number and then making its way through to liquidity.

Ralph Strata

Okay. Okay. That's great. And then one last one for me. So has the current unencumbered asset pool now been exhausted with the two financings at the end of July? Or is there additional flexibility there?

Gary Osborne

So in the quarter we completed … what we did is we completed financing on two aircraft that were with IndiGo that we had taken at the end of last year, so that was the $18 million. And when you look through we also moved some financing. We had five ex-Flybe Q400s. They were fully encumbered. What we did is we moved three. We took the loans off of three and transferred them to two other performing aircraft. So we still have now three Q400s that are unencumbered under that.

So it was bit of a swap we did during the quarter. So we did some things there to really help free up that fleet and make it a little easier to remarket.

Ralph Strata

Okay. Okay. Understood. That's it for me. Thanks, guys.

Gary Osborne

Yep.

Operator

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

And we have no further questions queued up at this time. I turn the call back over to the presenters.

Nathalie Megann

Thank you very much, Operator, and thank you, everyone, for taking the time with us this morning.

We'll now conclude the call.

Operator

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