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FINAL TRANSCRIPT

Chorus Aviation Inc.

Third Quarter 2020 Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Chorus Aviation Inc. Third Quarter 2020 Earnings 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 the session, you will need to press *, 1 on your telephone.

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

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

I'd now like to hand the conference over to your moderator for today. Nathalie Megann, Vice President, Investor Relations and Corporate Affairs, please go ahead.

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

Thank you, Jack. Hello, and thank you for joining us today for our third 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 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 information and statements, which are subject to various risks, uncertainties, and assumptions that are included or referenced in our management's discussion and analysis of the results and operations of Chorus Aviation Inc. for the period ended September 30, 2020, 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, 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.

Our efforts continue to focus on ensuring safe operations, preserving our liquidity, and working with Air Canada and other customers to help them navigate through this ongoing pandemic. We are also advocating for government support for the recovery of the Canadian aviation sector.

Gary will take you through our financial performance for the third quarter, which delivered earnings of $0.13 per basic share, or $0.07 on an adjusted basis. Our liquidity now stands at $218 million.

In the quarter, our CPA flying increased from 10 percent to 23 percent over the second quarter of this year. Our non-CPA lessees are showing moderate signs of more flying activity, as evidenced by an increase from 28 percent in lease revenue collected in the second quarter to 50 percent collected in the third quarter. We were also pleased to see this trend continue further, with further improvement in October with the receipt of approximately 58 percent in billed lease payments.

Unfortunately, COVID-19 continues to spread around the world. We're seeing signs of a corresponding stalling in the resumption of flying activity globally. We are encouraged by the public statements made by the Honourable Marc Garneau, Canada's Minister of Transport, on November 8th to begin immediate discussions with airlines on measures to protect Canadians from the impacts of COVID-19 on the air travel sector in Canada, and we are awaiting further details.

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, communities, businesses, academia, and tourism operators will struggle.

We believe the aviation industry will eventually recover. People will travel again. We still believe the regional sector is the most resilient of the industry, with domestic travel being the first to resume. Demand for regional aircraft remains stronger than other aircraft types, and we're seeing the Airbus 220 leading the pack. In fact, we delivered the third of five new A220-300s to airBaltic of Latvia in September.

Without knowing the length and depth of the damage resulting from the virus, it's difficult to predict how our industry and those entities that depend on it will manage. A prolonged pandemic will continue to challenge the passenger aviation industry. We recognize the recovery of passenger traffic will be protracted, sporadic, and will extend well into 2021 and beyond. We are taking all reasonable measures to protect and preserve our company.

Overall, our portfolio of leased aircraft is holding up relatively well in the current environment. As previously reported, Aeromexico filed for voluntary Chapter 11 petitions in the United States on June 30th in order to implement a financial restructuring. We have three E190s on lease to Aeromexico and hold security packages in respect of these aircraft. The aircraft are currently active in Aeromexico's operation, and we're hopeful that they will be retained by the carrier.

Voyageur is performing well. We continue to bid on new flying contracts and have had some success, including contract extensions. This is really the norm in the specialized contract flying business. It's an ongoing cycle, and our employees are experts in delivering the highly unique and customized services our customers require.

While our part sales division is challenged due to the pandemic, our MRO activity has increased after winning several new contracts in the second quarter.

It was a welcome piece of good news when Jazz was named amongst Canada's Safest Employers 2020, winning gold in the Public Transportation category. This is Jazz's fourth consecutive year accepting awards at the Canada's Safest Employers event. Last year, Jazz received gold award in the Transportation category. In 2018, Jazz was awarded silver in the Transportation and Psychological Safety categories. And in 2017, Jazz won gold in the Transportation category. My sincerest congratulations to the team. It's a great bright spot to have these days.

As mentioned, our Air Canada Express operation is now at 23 percent of what it was in the same period last year. We continue to work closely with Air Canada to help support its network and to reduce costs. Demand for air service will only return when people have confidence that their health and safety are protected and when the requirement for quarantine is reduced or eliminated.

In Canada, we need a national COVID-19 testing regime that uses scientifically based procedures to help facilitate the safe movement of passengers. This will allow an improved application of any quarantine restrictions. I applaud Air Canada's efforts in working with McMaster HealthLabs and the Greater Toronto Airport Authority to demonstrate the validity of testing as a means to ease travel restrictions and quarantine requirements, and we'll be watching for developments in this regard, as well, at Calgary's airport.

While the pilot programs underway in Calgary and Toronto to safely test an alternative to the two-week quarantine for international travellers are positive steps, more such programs are needed, especially with the Atlantic bubble. Again, we urge government to act swiftly to implement current science-based approaches to COVID-19 testing of passengers to help support the recovery of passenger demand.

In addition to feeling safe, passengers need affordable air transportation. In Canada, the multiple layers of fees and charges levied on passengers and airlines by various levels of government have greatly increased over the years and have had a disproportionately negative impact on regional services. Since the pandemic, Nav Canada has increased fees by 30 percent, and many airport authorities across Canada have also increased their charges by similar amounts, adding to higher ticket prices for travellers.

In the short term, the Government of Canada needs to urgently consider assisting these service providers and rolling back these fee increases to help encourage travel demand, thereby helping the economy and the transportation sector recover.

I'll conclude my comments first by thanking our employees, including those who are currently on inactive status, for supporting our company in these difficult times. I sincerely look forward to the day when we're all at our posts and resuming the meaningful work we've done to grow and diversify our business.

Secondly, I will not be providing any comments on the preliminary nonbinding acquisition proposal we received last month, except to emphasize that the disclosure was made at the request of IROC. We do not have anything further to say on this matter at this time.

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

Gary Osborne — Chief Financial Officer, Chorus Aviation Inc.

Thank you, Joe, and good morning. Our third quarter adjusted EBITDA was $85.9 million, a $6.8 million decrease over third quarter 2019. Adjusted net income was $10.9 million, an $18.2 million decrease over last year, which led to a decrease in adjusted EPS at $0.07 versus $0.18 last year.

Here's how the third quarter of this year compares to 2019. The Regional Aircraft Leasing segment's adjusted EBITDA decreased by $4 million, primarily due to a $4.1 million expected credit loss provision related to management's assessment of Chorus's lessee credit risk, and lower margins due to the loss of revenue resulting from the repossession of 13 aircraft from three lessees, partially offset by growth in aircraft earning leasing revenues.

Due to the impact of COVID-19, the non-cash general aircraft impairment provision of $11.2 million and $0.7 million for lease repossession costs were added back to adjusted EBITDA.

The Regional Aviation Services segment's adjusted EBITDA decreased by $2.8 million. The results were primarily impacted by decreased capitalization of major maintenance overhauls on owned aircraft operated under the CPA of $2.7 million, and a reduction in other revenue due to a decrease in third-party maintenance, repair, and overhaul activity, and reduced contract flying due to the economic impact of COVID-19, offset by decreased stock-based compensation of $1.7 million, increased aircraft leasing under the CPA, and decreased general administrative expenses.

Adjusted net income was $10.9 million for the quarter, a decrease of $18.2 million, due to a $6.8 million decrease in adjusted EBITDA as previously described; an increase in depreciation of $4.5 million, primarily related to additional aircraft in the Regional Aircraft Leasing segment; an increase in net interest costs of $7.6 million, primarily related to the 5.75 percent unsecured debentures, the unsecured revolving credit facility, and additional aircraft debt in the Regional Aircraft Leasing segment; and an increase of $3 million in realized foreign exchange and unrealized foreign exchange losses on working capital, offset by a $3 million decrease in adjusted income tax expense.

Net income decreased $3.7 million due to the previously noted $18.2 million decrease in adjusted net income, $11.2 million general impairment provision, and $0.7 million in lease repossession costs, offset by the change in net unrealized foreign exchange on long-term debt of $24.9 million and tax recovery on adjusted items of $1.5 million.

Liquidity improved in the third quarter by approximately $30 million, with $218 million in liquidity, including $35 million of available room on our committed revolving debt facility. This improvement was primarily due to pause of operating cash flows, working capital improvements resulting from increased flight operations, and the financing of previously unencumbered aircraft.

And as mentioned above, working capital improved in the quarter, primarily related to increased accounts payable due to increased airline operations over the second quarter, in addition to increased interest accruals related to the timing of debenture interest payments, and interest associated with the loan deferral program, partially offset by an increase in Air Canada receivables and CAC lease deferral receivables.

Other key liquidity movements in the quarter include payments on long-term borrowings of $31.6 million and investments in property and equipment, net of financing, of $13.2 million.

Cash increased in the quarter, primarily due to the increase in loan repayment deferrals of $13.5 million, or approximately US$10 million, with our largest lender, EDC. These deferrals allow us to defer our payments of principal and interest to the end of the year, providing us the ability to better match our debt payments with the lease deferral arrangements.

In the fourth quarter, we expect our liquidity to be relatively constant as we continue with measures to preserve liquidity, given the uncertainty related to the duration and impact of COVID-19. As we look ahead, we have seen our rental revenue received in the Regional Aircraft Leasing division increase to 58 percent in October, and we expect this will continue to improve over the next quarters as travel restrictions ease and airlines are able to increase their revenue-generating capacity.

We have reduced our capital expenditure forecast by $6 million since our second report-out and forecast maintenance capital expenditures and heavy checks to be within a planned range of $17 million to $23 million for the year.

Aircraft-related acquisitions are expected to be between $417 million and $426 million, down $64 million from previous disclosure, as a result of two aircraft for an undisclosed customer being moved to 2021 and a decrease in foreign exchange rate.

We estimate our cash outlay for the remaining growth CapEx expenditures to be approximately $10 million, net of anticipated financing arrangements. The remaining deliveries are subject to financing and certain closing terms.

That concludes my commentary. Thank you for listening.

Operator, we open the call to questions from the analyst community when you are ready.

Q&A

Operator

Certainly. At this time, if you'd like to ask a question, please press *, 1 on your telephone keypad. We'll pause for a moment to compile the Q&A roster. Again, that is *, 1 on your telephone keypad.

Konark Gupta with Scotiabank, your line is open. Mr. Gupta, your line is open.

Amina Djirdeh — Scotiabank

Hello? Can you hear me? Hello?

Joe Randell

Hello.

Nathalie Megann

Hello.

Gary Osborne

Hello.

Amina Djirdeh

Yes. This is Amina, Konark's associate. I do have a question on liquidity. You expect liquidity to remain relatively stable in Q4 with the extension of the CAC loan deferral and the secured financing of the six CRJ900s. How should we think about funding the two A220s for the airBaltic cash flow operations and working capital in Q4?

Gary Osborne

So, it's Gary here. We expect to remain relatively constant in the quarter, in and around that $200 million that we talked about in Q2 as far as liquidity goes.

As far as the A220s, if you look at the disclosure, we put in around C$10 million as being the net-of-financing amount that will be the draw related to those. So that's how you can model the A220s.

Amina Djirdeh

Okay. Thank you. No other questions.

Joe Randell

Yup.

Operator

Doug Taylor with Canaccord Genuity, your line is open.

Doug Taylor — Canaccord Genuity

Yeah. I'd like to follow that up. First of all, good morning. I would like to follow up with another couple of questions about the liquidity. I mean, are you planning any other liquidity enhancement measures outside of your general cash flow for Q4 to help keep it at that $200 million level?

Gary Osborne

No, we are not, Doug. That is based on the current status and continuing as we are.

Doug Taylor

And then in terms of the drain on your liquidity caused by commitments that you made perhaps prior to COVID with respect to the leasing fleet, would you see Q4 now as being kind of the last remaining major kind of hurdle or drain? And then as we look into next year with the capital commitments that you have, do you expect the pressure on your liquidity from those commitments to ease? Is that the right way to think about it?

Gary Osborne

By and large. I think if you look at what we've got, we've got two A220s coming in for roughly C$10 million. We still have two to an undisclosed customer some time next year. The timing of that is quite fluid, and we don't know exactly where it's going to happen. But that is it for the current commitments.

Joe Randell

And the CRJs will be delivered by the end of the—

Gary Osborne

And the other side to note too is back to our disclosure, we did pay all the equity requirements on all the CRJ900s in Q3, so the remaining CRJ900s that come in will not draw any cash because the financing will cover the remainder for those aircraft.

Doug Taylor

Okay. Maybe the last question about liquidity. I mean, just to be clear, the receivable related to the Guardrail with Air Canada that has been building up on your balance sheet, can you just confirm for us the timing of the expected collection of that?

Gary Osborne

It is Q1 next year.

Doug Taylor

Okay. So I mean, stepping back and looking back at the lease portfolio, would you say Q3, with all of the aircraft that are now being remarketed and have come out of the lease portfolio, is a good baseline in terms of the revenue and profitability of that business and then these additions in terms of the airBaltic A220s, I mean, should be additive of that earnings power of that portfolio going forward? I mean, generally or qualitatively? Is that the right way to think about it?

Gary Osborne

I think you can look at Q3 as having the sum of all the events that we've seen to date. So you've got the 13 aircraft essentially, by and large. You've got the 50 percent as far as revenue collected. So I think it's a good base moving forward, Doug. And then as far as layering things in, we have a couple more A220s to come in. We continue to monitor our lessees.

It is a dynamic situation in the marketplace, so it's hard to really give you a lot of guidance around that. We're hoping the rental revenue will increase. It was 58 percent in October and we're cautiously optimistic around that, but we continue to evaluate the lessees. So those bumps and things like that that could be associated with that are very difficult to predict. But I think if you look at where we're at today in Q3, and it's not a bad launching-off point for your modelling and where we're going to move from go-forward.

Doug Taylor

That's helpful. And just to be clear, I mean, going from 50 percent to 58 percent, the degree of collections does not have bearing on the earnings power. That's more of a balance sheet item.

Gary Osborne

You got it. Yeah.

Doug Taylor

Yeah.

Gary Osborne

You're right.

Doug Taylor

Just a couple of credit questions. First of all, I mean, airBaltic, are they among the members of your lessee that are current with their payments?

Gary Osborne

Yes, they are. We have no issues with airBaltic on their payment terms.

Doug Taylor

Okay. And then last one for me. The $4.1 million reduction in earnings related to the credit provision you've taken, is that related to a single entity? Or is that multiple airlines that you've taken some provisions on?

Gary Osborne

It's across all lessees. We evaluate them for expected credit loss or risk associated with the receivable, and we book the provision related to all of them.

Doug Taylor

Okay. I've probably asked enough questions. I'll pass the line.

Operator

David Ocampo with Cormark Securities, your line is open.

David Ocampo — Cormark Securities

Thanks. I just wanted to follow up on Doug's question related to the Cost Guardrail. I'm just trying to get a sense of the accounting treatment behind that. Was the payments recognized on the income statement for each respective quarter? Or is that something that's going to all appear in Q1?

Gary Osborne

So what happens is, we've recognized the revenue as we go through each quarter related to the Controllable Cost Guardrail. And what ends up happening is, you'll see the receivable bills, they'll be in the accounts receivables balance, obviously, reducing our cash. And then in Q1 next year, we'll collect that and it'll go back into cash.

David Ocampo

Okay. That makes sense, Gary. And this is a bit of a longer-term question, so I appreciate if you can't answer it. But when we look at the 2026 to 2035 period for your CPA agreement, there is a noticeable step down. And I always assumed that this would get backfilled somehow with some sort of leasing revenue. But maybe you can comment on your discussions with Air Canada. And perhaps should we think of this as a more permanent step down now, given the state of the industry?

Joe Randell

Well, we're obviously speaking with Air Canada frequently and considering the ever-changing market dynamics, there's still a lot of unknowns. For now, we're continuing to focus on the reduction of costs and as well, helping Air Canada preserve and plan on how it's going to recover its network here.

So we're having those discussions, and the fleet commitment remains in place in the CPA. But of course, as we look forward, we look at various scenarios and working closely with Air Canada to find ways that we can assist and work together to improve our outlook on both sides.

David Ocampo

That's great, Joe. And then the last one here for me. Just on the aircraft that have been repossessed. How much leniency do you guys have with the remarketing term? I know some of them are as short as six months before you have to make those bullet payments on the debt structures.

Gary Osborne

So if you look at the aircraft that have been repossessed, all but three have remarketing periods that are 24 months, as they're through EDC. And we're working with the lender on that remaining amount. It's around US$10 million that could potentially come due if circumstance warrant in Q1, but we are prepared around that piece. We're not worried at all about that loan call.

David Ocampo

That's great. That's it for me, guys. Thanks.

Gary Osborne

Okay.

Operator

Again, if you'd like to ask a question, please press *, 1 on your telephone keypad.

Ryall Stroud with RBC Capital Markets, your line is open.

Ryall Stroud — RBC Capital Markets

Hi. Good morning. It's Ryall calling in for Walter.

Joe Randell

Good morning.

Ryall Stroud

Just to quickly kind of start off here. I was wondering if you're able to unpack some of the detail in the working capital trend expected during Q4 and perhaps even Q1 as well? It sounds as though receivable headwinds in leasing are expected to be partially offset by security packages, so just kind of trying to wrap my head around it. Is it fair to assume a modest working capital headwind in Q4?

Gary Osborne

Yeah. I think you can assume a modest one. Q4 is always, if you look at even the CPA division and past-year traffic in general, it's always a slower period. And I think with the COVID environment, it's probably a little more than normal. So there'll be a little bit of a draw in that range.

But then you don't want it to turn around and say, look, we also are still generating positive cash from operations. Our receipts from the Regional Aircraft Leasing side are coming in a bit above what we saw in Q3. So I think you can model overall based on the guidance we've given you, the CPA Guardrails and the lease receivables and the deferrals. I mean, you can get a pretty good idea that there's a little bit of a draw there.

Ryall Stroud

Okay. No, that's helpful. That's it for me too. I'll pass the line. Thanks.

Operator

Again, if you'd like to ask a question, please press *, 1 on your telephone keypad.

There are no further questions at this time.

It’s now my pleasure to turn the call back over to Chorus Aviation for closing remarks.

Nathalie Megann

Thank you very much, Jack. We will now conclude the call and thank everyone for dialling in. Have a great day.

Operator

This concludes today’s call. We thank you for your participation. You may now disconnect.