FINAL TRANSCRIPT

Chorus Aviation Inc.

Third Quarter 2023 Financial Results Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Chorus Aviation, Inc., Third Quarter 2023 Financial Results Conference Call. (Operator Instructions)

This call is being recorded on Thursday, November 9, 2023.

I would now like to turn the conference over to Tyrone Cotie. Please go ahead.

Tyrone Cotie —Vice President, Treasury and Investor Relations

Thank you, Colin.

Hello, and thank you for joining us today for our third quarter 2023 conference call and audio webcast. With me today from Chorus are Colin Copp, President and Chief Executive Officer, and Gary Osborne, Chief Financial Officer.

We will begin today's call with a brief summary of the results, followed by questions from the analyst community.

As there may be some forward-looking information during the call, I ask that you refer to the caution regarding forward-looking statements and information found in our MD&A. This pertains specifically to the results and operations of Chorus Aviation, Inc., for the three months ended September 30, 2023, as well as the Outlook section and other sections of our MD&A where such statements appear.

In addition, some of the following discussion involves non-GAAP financial measures including references to adjusted net income, adjusted EBT, Adjusted EBITDA, leverage ratio and free cash flow. Please refer to our MD&A for discussion relating to the use of such non-GAAP measures.

I will now turn the call over to Colin Copp.

Colin Copp – President and Chief Executive Officer

Good morning, everyone, and thank you, Tyrone.

This is my third quarter reporting out as CEO and I am pleased with our team's steady progress over the past few months. This quarter, we continue to execute on our plan, making solid improvements in our balance sheet flexibility and progress on our deleveraging objectives.

As our team works diligently to respond to the ongoing macroeconomic challenges affecting our industry, we remain focused on improving our core business fundamentals. That includes improving our free cash flow and working to bring our leverage ratio with a long-term target of 2.5 to 3.5.

To that end, I am pleased to report the Chorus generated $113.7 million in free cash flow this quarter as we improved our leverage ratio from 4.4 at the end of 2022, to 3.6 this quarter while continuing to generate reliable and solid earnings.

As we prepare our business for long-term growth and ability, I'm pleased to report that after a year and a half following the Falko acquisition. We see the industry recovering nicely with a growing market demand and we remain very confident about the regional aircraft leasing sector. We see ourselves as well placed in this space with Falko taking a leading market position.

We recognize that Fund III is on the minds of our shareholders and analysts today. While we can't comment on the specific timing around the launch of Fund III, I can say the discussions with investors continue to be positive. It's also important to appreciate that we are not alone in the uncertainty related to the timing of fundraising.

The fundamentals of the regional aircraft leasing space remain strong, and we are confident in the future of the regional leasing business. Generally, airline market conditions have recovered well with strong Q3 earnings reported by several operators, as the industry sees good demand across all markets for aircraft capacity.

Additionally, we continue to see industry constraints on MRO capacity and pressure on the supply chain impacting new aircraft deliveries, which has created an imbalance in aircraft supply versus demand. All of which supports, that in general, lease rates are improving across almost all regional jet types and previously idle aircraft are being put back to work.

Let me share some highlights related to Falko's performance, facts that support potential for long-term value for our shareholders from this transaction.

Jeremy has an incredible aircraft commercial team at Falko with deep industry experience. In the third quarter alone, they've successfully closed on 17 aircraft transactions, including purchases of aircraft with leases attached and placement of idle aircraft on lease and lease extensions. These transactions took place with nine distinct airline customers across six continents.

The momentum has continued, and since September 30, the Falko team has signed several additional letters of intent and are making excellent progress to conclude those transactions in the coming months. Falko successfully continues to deploy capital from Fund II in support of these activities and Fund II remains on track to hit target returns for investors in the mid-teens.

Furthermore, Falko has generated net proceeds from wholly owned asset sales of approximately US$102 million so far and we expect to transact further across sales in the fourth quarter that Gary will speak to shortly. In conclusion, Falko is executing very well, and we are optimistic in Falko's growth opportunities.

On the regional aviation services side of the business, we've seen consistent, solid performance. In August, Randolph and the Jazz team were successful in working with our pilot union, ALPA, to ratify a significant modification of the pilot collective agreement, securing a new industry competitive compensation structure. Jazz and ALPA have a proven history of working together collaboratively to find creative solutions, and this is yet another great example.

This agreement will be instrumental in addressing the changing pilot wage environment and expanding pilot recruitment and training capacity, which will in turn strengthen the pilot supply and overall flying capacity.

Jazz has a long-demonstrated partnership with Air Canada and was able to reach an agreement with Air Canada on the changes consistent with the terms of the capacity purchase agreement.

Our pilot training academy, Cygnet, led by Lynn, continues its growth with its third cohort of students having started in August of this year. Through its partnership with CAE, Cygnet is delivering a first-of-its-kind direct entry cadet program by innovating flight training with the best-in-class scenario-based and simulation techniques and technologies. Cygnet is taking its place as a leader in helping address the industry-wide need for more pilots.

Cory and the team at Voyager are making excellent progress and continue to execute on their growth plans in the special mission, defense, and parts space. There are many opportunities to build on there, including the Government of Canada contract in support of Canada's manned airborne intelligence surveillance and reconnaissance program, known as MAISR.

This quarter, Voyager added the ATR aircraft to its product offering, further diversifying the business and building on their capabilities. In July, Voyager also announced an amendment to its contract with Air Ambulance, New Brunswick, providing new capacity.

Yesterday we announced that Chorus is renewing its Normal Chorus Issuer Bid. Under the renewed bid, which takes effect on November 14, we will have the ability to purchase, for cancellation, up to 15.1 million of our common shares. Last year, we took the opportunity to repurchase and cancel 9.1 million shares.

In conclusion, I'd like to say that we're executing on our plan, generating strong free cash flow to de-lever and de-risk the business. Overall, we're making important improvements in our balance sheet flexibility following an unprecedented time in our sector.

When you combine the strategic progress with our stable earnings, positive news related to our subsidiaries activities and implementation of the long-term measures like the recent pilot agreement, we are making solid progress.

I'd like to conclude by thanking our employees and the leadership team who are central to both the delivery of our services as well as the execution of our strategy. Together, our talented team is helping lead course into the next phase of its success and growth to rebuild value for our shareholders.

Thank you. I will now pass it over to you, Gary, to take you through the financials.

Gary Osborne – Chief Financial Officer

Thank you, Colin, and good morning.

The third quarter 2023 results were mostly in line with our expectations, and we remain on track to meet our guidance for the 2023 year. We are currently tracking to be at the higher end of guidance for revenue, Adjusted EBITDA, free cash flow and leverage, and at the lower end for adjusted EBT. As Colin mentioned, we continue to make steady progress on our strategy and objective to deleverage and increase our balance sheet flexibility.

Our leverage ratio at quarter-end was 3.6, a decrease from the 2022-year end of 4.4, largely due to the year-to-date long-term debt reduction of $259.8 million. This placed our Q3 2023 leverage close to the top end of our investor day targeted range of 2.5 to 3.5.

Our cash flow generation remains strong. We generated solid free cash flow of $113.7 million, and while lower than the prior period, the reduction is due to the net proceeds from Q3 2022 asset sales offset by stronger cash flow from operations, including the non-recurring defined benefit pension revenue of $29.9 million.

The DB pension revenue reflects our agreement with Air Canada to compensate us for the impact of the new pilot wage rate scales on the defined pension benefit liability. This receivable will be collected over 60 months and matches the expected past service funding to the plan over the same period.

On a year-to-date basis, our free cash flow increased from $233 million in 2022 to $257 million, which reflects our strong cash-from-operations and impact of the Falko acquisition.

As I said earlier, our third-quarter earnings were largely in line with our expectations. The RAS segment continued to perform well with an Adjusted EBITDA of $62.3 million, in line with the third quarter of 2022. The RAL segment's Adjusted EBITDA was $56.1 million, a decrease of $13.7 million over the third quarter of 2022, mainly attributable to lower lease revenue of $8.6 million, which includes the impact of the 2022 asset sales, which decreased lease revenue, recovered claims in the Virgin Australia bankruptcy in 2022, partially offset by increased lease revenue from released aircraft, the recognition of end of lease compensation and a higher US dollar rate. We also saw a decrease in the net gain on sale of assets of $2.7 million and an increase in general administrative expenses.

Corporate Adjusted EBITDA was a negative $5.3 million and improved from the third quarter of 2022 by $3.2 million due to a decrease in stock-based compensation and general administrative expenses.

Adjusted earnings available to common shareholders were $0.06 per share. Earnings, while lower than 2022 by $0.09 per share, are supported by strong free cashflows, lower leverage levels, and our assets that are supported by our underlying contracts.

During the quarter, we also recorded impairments at $25.7 million, which represents less than 1% of our consolidated assets. In accordance with IFRS, we assess our aircraft for impairment at least on an annual basis or in circumstances indicating impairment may be required. Our impairment assessment includes many factors, including the weighted average cost of capital, lease cash flows, maintenance return conditions, current aircraft market values, and residual values.

For the quarter, we ended with—our liquidity ended at $210.6 million. Liquidity increased from the second quarter of 2023 by $65.6 million, primarily due to a prepayment in September for October's controllable cost revenue of $47.8 million and strong cash flows from operations.

On November 1, 2023, we entered into two new facilities to add flexibility to our capital structure by adding a one-year $30 million unsecured facility and a $50 million secured facility that goes to the end of 2025, providing us with flexibility with regards to the repayment of our Series A debentures that mature in December 2024.

Turning to asset sales, we continue to opportunistically trade for our fully owned or majority-owned aircraft. We are currently in discussions on sales opportunities that we expect to close before year-end, which will place us at the lower end of our guidance for asset sales and net proceeds. We've also just renewed the NCIB until November 2024, under which we can purchase up to another 15 million shares. Under the prior NCIB, we purchased a total of 9.1 million shares.

As I mentioned earlier, we are maintaining our overall guidance for 2023 that's contained in the Outlook section of our MD&A.

We are now ready for your questions.

Q & A

Operator

Thank you. (Operator Instructions) Your first question comes from Hillary Cacanando. Hillary, please go ahead.

Hillary Cacanando – Deutsche Bank Securities

Hi, thank you for taking my question. I know you said you can't comment on the timing of the Fund III, but I was wondering if you could share some of the feedback that you've gotten from investors. Is the delay just purely macroeconomic driven, or is there any—is there a hesitation, what's causing it or what's the cause of the delay? It seems like it's macro-driven, but I was wondering if you could share some of the feedback you've gotten from investors.

Colin Copp – President and Chief Executive Officer

Hi, Hillary, it's Colin. Yes, and Gary can probably add a bit to this, but look, we don't have a heck a lot more than what I commented on in my script there. It's the macroeconomics that we see is the bigger issue here. I think the opportunity is still there. There's lots of discussion going on. It's really more of a matter of timing which is very hard for us to really predict as far as things go forward.

Gary Osborne – Chief Financial Officer

Yes, Hillary, it's Gary. Just to reiterate what Colin said, the feedback's good. People still like the asset class, the regional aviation space. They like the team at Falko and how they manage the assets. They like the targeted rate of returns. It is more market driven at this stage.

Hillary Cacanando – Deutsche Bank Securities

Okay, got it. Previously you had mentioned that you were looking to make some acquisitions. Is that still on the table? Any comment on that would be appreciated. Thank you.

Colin Copp – President and Chief Executive Officer

Yes. As we move ahead, we continue to delever. Our free cash flows are good, it's going to provide us some opportunities as time goes on for some type of growth opportunities that you're speaking to, particularly on the RAS side of the equation. We're certainly continuing to look but it's a position and the balance sheet that will certainly help out.

Hillary Cacanando – Deutsche Bank Securities

Got it. Thank you very much.

Colin Copp – President and Chief Executive Officer

Thank you.

Gary Osborne — Chief Financial Officer

Thank you.

Operator

Your next question comes from Kevin Chiang from CIBC. Kevin, please go ahead.

Kevin Chiang – CIBC

Thanks for taking my question. Maybe just a clarification question on the impairment provision you took in the quarters. Just anything to call out there, any additional color you can provide on the $26 million you booked in Q3?

Colin Copp – President and Chief Executive Officer

No, there's really not much, Kevin. I think it's just a general review that we do annually around this lease, and it just reflects everything I've talked about, future cash flows, wage and average cost capital, etc. Really nothing to really report there other than the ordinary.

Kevin Chiang – CIBC

Okay. Maybe I'll approach the Fund III question differently. Do you think that limits some of the other initiatives you've laid out and you have laid—you did lay out back at your investor day, growth within Voyager, maybe how aggressive you want to be on returning cash shareholders. Does it limit what you can do there until Fund III closes or the capital that you'll deploy into Fund III, that's essentially to set aside and any other kind of non-Falko related growth initiatives, you can continue to pursue that regardless of the timing around Fund III.

Gary Osborne – Chief Financial Officer

Yes, it's Gary here, Kevin. Yes, I think Fund III, we're continuing to get positive feedback, but market timing is what it is. It doesn't preclude us from still investing in the other sides of the business, their other opportunities. Right back to it, we're continuing to deleverage, and that's going to give us the opportunities to do that, and we continue to look at them. But yes, the Fund III piece is separate from these other investments.

Kevin Chiang – CIBC

I know you've set a percentage amount that you'd invest in the fund. Would you increase your percentage, whatever the right amount would be, an extra 5%, 6%, whatever, to get the fund across the line or is it a hard line? I think it's like 15% of the fund. Is that a hard glass ceiling for you in terms of not wanting to invest more than that amount, or would you be open to moving that up a little bit just to get the fund at a certain size and to get it closed sooner?

Gary Osborne – Chief Financial Officer

Yes. Kevin, I think 15% would be the limit that we would look at. Part of that is, A, we still want to be able to invest in all parts of our business. Also, once you start getting above that, that's—you start to—essentially, you get in the position where you may have to consolidate the earnings and we're not doing that.

Kevin Chiang – CIBC

Okay. I'll leave it there. Thank you very much.

Operator

Your next question comes from Konark Gupta from Scotiabank. Please go ahead.

Konark Gupta – Scotiabank

Thanks, Operator. Good morning, everyone. Just a first question, maybe, Gary, for the third quarter, the gap between EBITDA and net income seemed pretty wide. It seems like the tax rate on an adjusted basis was about 34%, much higher than last year and a little bit higher than Q2. Any reason for the tax rate to be higher in Q3?

Gary Osborne – Chief Financial Officer

Yes. Thanks, Konark. If you look at where the earnings are coming from, they're in the RAS section and also in the corporate, which has a higher rate, statutory rate. When you look at the RAL side, it's really a function of where some of those losses or gains or revenues are or income and it's just the way it's played through the statements. When you look at that, it's certainly—the rate is disproportionate probably to the earnings just in the short term. If you look over the long term, 20% to 25% is— these are things that we would expect to see as far as that against adjusted EBT as far as the income tax rate.

Konark Gupta – Scotiabank

That's great. Thanks. It seems like in the MD&A, you guys disclosed the pilot contract and then Air Canada's contribution toward that. Can you share any high-level terms about the funded contracts? We have seen anywhere from like 20%, 25% to 40% increases across the industry in the US and Canada. Any sense on your contract?

Colin Copp – President and Chief Executive Officer

Hi, Konark, it's Colin. We've been pretty, I think, transparent on that to the best of our ability. We've been able to find a solution that really is industry competitive and that's where we stuck with it. There's a lot of variables that go into that and really all I can give you is that it's an industry competitive place on the overall compensation is where we ended up.

Konark Gupta – Scotiabank

That's fair, Colin. Thanks. Last one for me, on the asset sales, I think I heard you guys saying that you are expecting to close some in Q4, but you'll be coming in at the low end of the target range for the full year. Is there any—is it more about timing, why the asset sales did not happen as much as you probably would have thought initially, or is it just the industry conditions where you want to utilize the assets more before you sell them?

Gary Osborne – Chief Financial Officer

Konark, it's Gary here. It's more just timing. If you recall, we've always said it's in the back half of the year. It just happens that it will be in the back half of the back half in this case. It's really just timing. It seems to culminate in the back half of the year. We're hoping that trend will change next year, and we'll have a little more even spread, but it's just actual market timing for the most part.

Konark Gupta – Scotiabank

I appreciate the comments. Thanks guys.

Operator

Your next question comes from Walter Spracklin from RBC Capital Markets. Walter, please go ahead.

Walter Spracklin – RBC Capital Markets

Thanks so much, Operator. Good morning, everyone. I want to follow up here on the pilot side. You said 300 pilots at Air Canada, training 300 over the last year, that's quite an accomplishment. I think Air Canada must be very happy with that pilot flow given how in-demand pilots are right now. I'm a little worried about your organization, though. If that many pilots are leaving and you're training so many, are you concerned at all that this puts a strain on your organization, your cost structure, and your operating performance. I'm just curious how you're dealing with that, let's call it turnover, it's not really turnover, but turnover in your pilot base, both from a cost structure and operating performance.

Colin Copp – President and Chief Executive Officer

Hi, Walter. Yes, it's Colin here. Yes, it's a good question. One thing Jazz is very good at as an industry leader in Canada, not even maybe to mention North America, is their ability to train pilots. We have our own internal training program. We run our own check-ins. We have our own Transport Canada authority to sign off pilots. We've done that for many, many years. That's an area that we're really, really, strong in.

We're not like most other operators that use CAE, training pilots to do simulative training. We do our own simulative training. We have a fairly large contingent of training pilots in our program and we've been at it for many, many years, as you know, we're pretty comfortable in that area. Yes, there's been a significant amount of movement. There's no question the industry has seen that. Jazz is the perfect place for large operators to find pilots. There's no question about that. I think most of the large operators in Canada have been looking to hire our pilots where they could. But that really hasn't impacted us that much.

The Air Canada flow is kind of something that I think we work together with Air Canada on capacity versus flow, and we look at that depending on what their needs are. We've been pretty successful at managing through that. Yes, the hours are a little constrained. There's no question about that, given all this activity. But we're pretty comfortable where we are. We've got this new collective agreement in place that's very competitive. We think that's—we don't think we know that's attracting really good talent coming in the door, we've seen all kinds of improvements here in the last little while if we put that in play. Our pilot training classes, every single one is full. We have no problems attracting talent. There's a bit of a—it's like anything, there's a bit of a challenge in making sure that you can get all the throughput done and you can get all the training accomplished for the right seasonal peaks. But that's all stuff we work with Air Canada on to work through. As far as the stress on the organization, I think there's probably nobody better in Canada to manage this volume of pilots and transition than ourselves.

Walter Spracklin – RBC Capital Markets

That's great. That's a great answer. You answered my second question, but I just want to make sure. Getting pilots, now you said your training, classes are full, because getting pilots sounds like, at least in the US, to be a fairly difficult thing. We're seeing some of the US regionals taking some fairly aggressive tactics to poach pilots from UPS and FedEx, I'm sure you've seen that news. You're not feeling the need to look at unconventional ways to get pilots in your classroom, is that right, Colin?

Colin Copp – President and Chief Executive Officer

No, no, we have no problems attracting quality people. We're very happy with where we are right now. I think, quite frankly, as we work closely with Air Canada, I think they're pretty happy with what we've been able to provide them. It's a good opportunity. If you're a pilot in the industry today and you're prepared to work hard and study and do all those things, it's a wonderful opportunity, a career opportunity for a pilot.

Walter Spracklin – RBC Capital Markets

Yes. That actually leads to my third question about Air Canada. They must be very happy. When you did this agreement, I think it was new at the time or not new but formalized very nicely at the time, but the conditions now have changed that I think the value of that agreement is much higher than what it was perhaps when you signed it. Is the terms of that subject to renewal anytime soon? Are you looking at crystallizing the value, the new value that that agreement has created? Just curious how you're framing your approach to this relationship or this part of the agreement with Air Canada.

Colin Copp – President and Chief Executive Officer

Yes. The way I look at Air Canada is, we're a committed partner, they're a committed partner, we've had great relationships. We've always been able to reinvent things as the years have transpired, the industry changes, there's a need for change and whether it's Air Canada asking for that or it's us, we've always been able to find a solution. Things will evolve, we're pretty happy with where they are right now. I think generally, we've got a solid collective agreement in place. We've got happy pilots. We're hiring like crazy. The organization's full of energy. Air Canada's happy with the flow that we've been able to provide. We want to provide that flow. Some of the attractiveness and the importance of being able to attract talent into us, into Jazz, is the fact that those opportunities exist at the mainline and that there's some mechanism to flow you through and move your career and progress your career. There's a huge advantage to that for us as well. Yes, it's working well right now. We had a couple of things we had to sort out and we got them sorted out as we always do and I'm sure there'll be more changes in the future as things evolve.

Walter Spracklin – RBC Capital Markets

Okay. That is great color. I really appreciate it. Thanks, everyone.

Colin Copp – President and Chief Executive Officer

You're welcome.

Operator

Your next question comes from Tim James from TD Cohen. Tim, please go ahead.

Tim James – TD Cohen

Thanks very much. Good morning. First question, Gary, the step up in depreciation expense sequentially in RAL, I am just wondering if you could talk a little bit about that. It sounds like there was an increase in depreciation rates and just what drove that or the need for that change.

Gary Osborne – Chief Financial Officer

Yes, Tim, it is Gary here. Yes, when you look at how we approach things, we continue to look at our depreciation and it is up a little bit, but it just reflects really where we expect the fleet to be, where it needs to be in the future as far as depreciation goes. It's just an annual exercise we do and it's just a little bit higher for sure than the prior quarter, but it's just reflecting where we expect the assets to be at the end of their lease in residual values.

Tim James – TD Cohen

Okay, thank you. My second question, the return on equity, it has dropped sequentially, and I think your expectation is for that to move higher again from the 10.5%, I think it was, on a trailing four-quarter basis. Could you just talk through the drivers of moving that return on equity higher here over the next couple of years, and I say drivers in terms of pricing, cost factors, just any of those kind of drivers that we should think about as to how it can increase.

Colin Copp – President and Chief Executive Officer

Yes, fair enough. Tim, as far as the ROE goes, as we reduce our earnings here in the short term, it certainly will come down a bit, but in the long run, as we reinvest back in the business and we allocate our capital appropriately, it is going to go back up. That's where the investments in RAS and other places like that will come in and also in the asset management platform within Falko. That will start to bring it back up. But in the short term, as the earnings come down, as you know, this year, 2023 and into 2024 is a bit of a repositioning, you'll see some decrease, but it'll start to grow from there as we start to allocate our capital to accretive transactions.

Tim James – TD Cohen

Okay. Thank you very much.

Colin Copp – President and Chief Executive Officer

Okay.

Operator

There are no further questions at this time. I will turn it back to Tyrone for closing remarks.

Tyrone Cotie – Vice President, Treasury and Investor Relations

Thank you, Colin, and thank you everyone for taking part in today's call. Have a good day.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.