FINAL TRANSCRIPT

Chorus Aviation Inc.

Second Quarter Earnings Conference Call

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PRESENTATION

Operator

Good morning. My name is Jodie (phon), and I will be your conference Operator today. At this time, I would like to welcome everyone to the Chorus Aviation Incorporated Second Quarter Earnings 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 would like to ask a question during this time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, press the # key. Thank you.

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

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

Thank you, Jodie. Hello, and thank you for joining us today for our second quarter 2017 conference call and audio webcast. With me today from Chorus are Joe Randell, President and Chief Executive Officer, and Jolene Mahody, Executive Vice President and Chief Financial Officer.

We'll start by giving a brief overview of the results, and then go onto questions from the analyst community.

Because some of this 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 on Page 7 of our Management's Discussion and Analysis of the results and operations of Chorus Aviation Inc. for the period ended June 30, 2017, 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 measures, including references to EBITDA, adjusted EBITDA, and adjusted net income. Please refer to Section 17 of our MD&A for the discussion relating to the use of such non-GAAP measures.

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

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

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

I'm pleased with our financial performance in the first half of this year, and we continue to deliver solid earnings.

Quarter over quarter, we generated an increase in adjusted EBITDA and adjusted net earnings of 13.3 percent and 22.3 percent, respectively, over the same period last year.

Our aircraft leasing strategy is quickly gaining momentum. In the last four months alone, Chorus Aviation Capital has acquired or signed purchase agreements for six ATR 72–600s, four Embraer 190s, and three Q400s. Within the first seven months of its existence, CAC has grown Chorus' fleet and regional aircraft outside of the CPA to 17 aircraft, with the average age of this fleet being approximately three years.

We are executing well with the addition of highly desirable regional aircraft from the top three manufacturers with some of the most reputable regional airlines in the world. To date, including the aircraft on lease under the CPA, pending acquisitions, and other third party leases, we've grown portfolio of leased aircraft to 56 with a value of over US$1 billion. We're well on our way to becoming one of the world's top regional aircraft lessors.

I'm confident this momentum will continue, as we have several exciting opportunities in the pipeline. We are being very thorough and methodical as we assess these opportunities, and are focused on making the right business decisions first and foremost.

To date, after closing on our recent announcements and the related financings, we will have committed approximately 50 percent of the capital raised with Fairfax, and anticipate deploying the balance over the next six to twelve months. We are also examining options for future financing to support our growth initiatives.

Along with the solid performance of our core businesses in Jazz and Voyageur, we are transforming our organization into a global leader in the field of regional aviation. We are now delivering customers a complete suite of regional aviation services, including contracted flying, aircraft engineering; maintenance, repair, and overhaul; parts provisioning; and aircraft leasing solutions. These strengths will grow our company and differentiate us from the competition.

On the Jazz front, strengthening our cost competitiveness remain a priority, and we have and continue to reduce our costs in many areas. Since January 2015, over 500 pilots have left Jazz through the pilot mobility program, retirement, or voluntary separation. This is a major component of our transformation, as the employee demographic is changing significantly and costs are reducing as planned.

In the second quarter, the number of pilots transitioning to Air Canada slowed under the pilot mobility program; however, we anticipate between 150 and 175 pilots in total will go to Air Canada this year. To balance Air Canada's needs with Jazz's own pilot requirements, the companies' recruitment teams have agreed on monthly Jazz pilot hiring limits.

Operational challenges at the main hub airports was the main factor in the decline of our operational performance in the second quarter. Runway construction in Toronto and other airports, as well as severe thunderstorms impacted our operation at our main hubs where we have the highest concentration of flights. Once these delays occur, it is very difficult to recover and get back on schedule.

This also has the effect of disrupting flight crew schedules and training, thus impacting pilot training rosters and impacted our flight completion performance.

In June, Jazz signed a five-year agreement with Bombardier Commercial Aircraft to designate Jazz technical services as an authorized service facility. This designation makes JTS authorized to conduct third-party maintenance, repair, and overhaul on Bombardier CRJ-100s, 200s, 700s, 900s, and 1000s, as well as Dash Q400s, and all other Dash 8 series aircrafts.

We were delighted to join Bombardier's customer support network, and collaborate on providing valued support to operators of Bombardier aircraft. This provides us with the opportunity to drive incremental revenues.

The team at Jazz Technical Services was highly productive in the quarter completing heavy maintenance checks on aircraft operated by CommutAir, a United Express regional partner; Air Georgian; and of course our own aircraft. They also completed the world's first extended service program on the first of 19 Dash 8–300 aircrafts.

The program extends the service life by approximately 15 years at a cost of approximately 3.5 million Canadian, and is a very good investment given there isn't a viable replacement for this capacity currently in the market. We expect to complete four ESPs this year, and I extend my congratulations to the team. They are all highly engaged.

Turning now to the Voyageur operation. Last quarter we talked about delivery of our first converted Dash 8–100 package freighter, and this month we expect to deliver the second to Wasaya Airways. This unique cargo aircraft was designed, engineered, and prepared at the Voyageur Aerotech facility in North Bay. With its 10,000-pound payload, we see potential for this new product in the future.

In the second quarter, Voyageur Airways commenced a new contracted flying mission in Denmark with a CRJ-200. Current missions in Sweden and South Sudan have also been extended several months with the possibilities for further extensions. We also have several outstanding bids for other new flying contracts.

The Voyageur MRO side of the business is performing to plan and continues to receive positive feedback from our customers. Our Avparts company acquired two CRJ-200 aircraft for part-out, and parted out a fourth former CPA Dash 8–100 in the quarter.

Looking ahead, we remain determined to create additional long-term shareholder value by strengthening the foundational CPA business, growing and diversifying aircraft leasing revenues, and pursuing additional growth opportunities. I look forward to updating you further next quarter on the transformation of our company.

I'll now turn the call over to Jolene, who will take your through the second quarter financial results.

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

Thank you, Joe, and good morning. Our second quarter financial performance was within our expectations, and I am pleased with our results.

Here's a breakdown of the second quarter compared to the same period in 2016. Chorus reported adjusted EBITDA of 65.5 million versus 57.8 million in 2016, an increase of 7.7 million or 13.3 percent.

The increase in adjusted EBITDA was primarily driven by increased aircraft leasing under the CPA with Air Canada of 6.4 million; a 4.6 million increase related to incremental margin attributed to non-CPA aircraft leasing and maintenance, repair and overhaul; and new contracts for international ACMI flying in the Voyageur operation, which contributed 0.7 million. These increases were partially offset by a decline of 2.4 million in CPA performance incentive revenue, and an increase of 1.6 million in stock-based compensation expense.

Adjusted net income was 26.7 million, or $0.22 per basic share for the quarter, an increase from the second quarter of 2016 of 4.9 million, or 22.3 percent. The change was a result of the 7.7 million increase in adjusted EBITDA previously described, plus a 3.5 million decrease in income taxes, which was partially offset by 2.7 million of additional depreciation primarily related to new aircraft, and 5.3 million of added interest costs related to increased aircraft debt and the convertible units.

Net income was 40.8 million for the quarter, or $0.33 per basic share, an increase of 17.2 million from the second quarter of 2016. The increase was due to the previously noted 4.9 million increase in adjusted net income and an increase of 16.3 million in unrealized foreign exchange gains on long-term debt, offset by 3.1 million of foreign exchange losses on US-dollar denominated cash held on deposit for investment in the aircraft leasing business, and 4.5 million in employee separation program costs incurred in the second quarter of 2017 as compared to 3.6 million in the second quarter of 2016.

While Billable Block Hours no longer directly affect our compensation, they are relevant to the rate-setting process on controllable costs and in determining controllable revenue. The controllable revenue rates are designed to deliver the fixed fee and infrastructure fee margin over an annual period if we manage our costs consistent with those assumed in the rate-setting exercise.

Based on updated planning assumptions from Air Canada, Billable Block Hours for 2017 are expected to range between 358,000 and 363,000 hours, which is based on 117 covered aircraft as at December 31, 2017. The actual number of billable block hours for 2017 may vary from this anticipated range due to several factors.

Our capital expenditure guidance for 2017, excluding those for the acquisition of aircraft and the extended service program on the Dash 8–300, but including capitalized heavy checks, is anticipated to range between 45 million and 55 million.

We are projecting 2017 expenditures for aircraft-related acquisitions and the extended service program to range between 428 million and 442 million. This includes the acquisition of two CRJ1000s, six ATR 72–600s, four Embraer 190s, three Q400s, and the extended service program, but it does not contemplate any potential future aircraft acquisitions.

For additional information supporting our projected guidance for the balance of the year, I'll refer you to Section 8, the 2017 Outlook section of our MD&A for the period ended June 30, 2017.

That concludes my commentary. Thank you for listening. And, Operator, we can now open the call to questions from the analyst community.

Q&A

Operator

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

Your first question comes from the line of Walter Spracklin with RBC. Your line is open. Please go ahead.

Walter Spracklin — RBC Capital Markets

Good morning, everyone.

Joe Randell

Good morning, Walter.

Walter Spracklin

So just stepping back a little bit first to the longer term out to 2020 with the new CPA terms that kick in in that year, you always indicated that with the restructured agreement and the move into leasing, the step-down that you're expecting in 2020 would be offset by the new business being brought on. Can you tell us if that's still the expectation of the trends that you're getting right now should lead to that, as planned? And how much of that shortfall would you consider to be covered right now with the new business you've brought on?

Nathalie Megann

So yeah, Walter, I think when we look at just the CPA alone, I think we've shared the projected numbers that would come from the split with the increase in aircraft leasing we're seeing under the CPA that's solidified—and those are the minimum based on the minimum fleet commitments—showing with those numbers the fact that the aircraft leasing coming off of the CPA is offsetting actually the reduction that we're seeing in the fixed fee post-2020, and that's just the CPA alone. So those numbers are out there and clear, and then anything that we're doing additionally beyond that with the new—outside of the CPA leasing business through CACC is just all incremental to that.

And clearly, we're pleased with how that's going. We've deployed, as Joe said in his remarks, just over half of the initial capital, and over the next 6 to 12 months see us deploying the rest of that. So certainly by 2020 the full amount of that deployment is kicking in and contributing plus.

Walter Spracklin

Got it. And on the 6 to 12 month, is that—for the balance—is that what you had been expecting previously? Or are we extending out? Are you seeing a little less opportunities now? Or was that always in the plan that kind of time frame?

Joe Randell

No, I think it's pretty close to what we had anticipated. In fact, it may be a little faster here than we anticipated. And since we've been out there now and we've had this capital, in fact we are more positive in terms of the opportunities that exist out there and our ability to deploy the capital in a timely manner.

And as I mentioned in my remarks, we're already, given the pipeline that's there and the other opportunities that we see, looking at how we achieve future capital in growing the business because this window we see now as being a significant opportunity, and we want to really capitalize on that. And I think it's better than we originally thought, actually.

Walter Spracklin

And when you—in terms of new capital, how much in advance do you like to have the capital secured before you're going out to look for that business? In other words, if you're 6 to 12 months out from using up what you have now, when would you like to see the next round come in ideally?

Joe Randell

Certainly within the next year or probably sooner than that is our goal.

Walter Spracklin

And do you expect that Fairfax would be the main source for new financing? Or would you more likely go with an alternative source?

Joe Randell

Well, we would have to look at all alternatives. Our relationship with Fairfax is great. They've been very supportive, et cetera. But as we grow the business we would obviously discuss opportunities with Fairfax, but it's to be determined as to exactly how we would raise the capital.

Walter Spracklin

And if you went alternative, is it just your broad expectation that the cost of financing would be kind of in line with what you got from Fairfax? Or would we see something different?

Joe Randell

I don't think—we'll see. We're going to actually try and bring it in as low as we possibly can. So our goal is to bring it in as low as we can. So it's hard to say.

It depends on where interest rates are and what happens over the next little while, but it's not going to be too far different, if that is the manner in which we do raise the capital. We're looking at various ways of raising the capital and our various alternatives. So I can't really say more than that on it at this time because we're right in the process now of trying to put our plans together in terms of what we do.

Walter Spracklin

Understood. And when you talked about further diversification initiatives outside the CPA, are there any that you're farther down the road with, you know, of the number that you did share in terms of avenues? Is there any that you feel kind of good about in terms of the bids that you've put in so far?

Joe Randell

Yeah. Well, I think the CPA is pretty stable. Voyageur has been growing some contracted flying. It’s not a large amount, but nevertheless it’s been seeing some traction in Europe, which is something we’re very pleased about.

The MRO side of the business, JTS has been very successful, and again, there are several opportunities that we’re pursuing there, so we’ll be focused on that. But our primary focus, without a doubt, is going to be on how we further move along in the opportunity on the leasing side.

Walter Spracklin

And last question for me: How successful have you been in terms of tying in your leasing, your new leasing business with your MRO? And has there been any challenges with regards to the reach of your MRO into some of the more further—into sort of the leasing that you’ve done that’s geographically further out?

Joe Randell

No, well, we’ve—these leases, these aircraft are all active, and of course generally on the other side of the world. So the opportunities on the MRO side so far have been limited, but I will say that we’ve drawn on the expertise and the knowledge of Voyageur and Jazz with respect to evaluating these airplanes, looking at their maintenance conditions, et cetera.

So we’re certainly leveraging our experience and our knowledge with respect to regional aircraft as we bring in these leases.

Walter Spracklin

Okay. That's all my questions. Thanks very much.

Operator

Your next question comes from the line of Cameron Doerksen with National Bank Financial. Your line is open. Please go ahead.

Cameron Doerksen — National Bank Financial

Yeah. Thank you, and good morning. I guess maybe first a clarification. You mentioned that just over 50 percent of the capital has now been committed to the leasing business. I'm just wondering if that's based on an assumption of 3:1 or 4:1 leverage?

Nathalie Megann

Three-to-one is really what you can assume there, Cameron.

Joe Randell

Yeah.

Cameron Doerksen

Okay. Perfect. And maybe you can just talk a little bit more broadly about financing these aircraft that are coming in? Is it the case that you're sort of assuming the debt that's associated with them? Are you refinancing the debt? And maybe you can just talk a bit about what kind of rates you'll be able to get on these aircraft that are coming in on the leasing side?

Nathalie Megann

Yeah. So in terms of the debt, some of them we're assuming financing on; others we're sourcing other financing on ourselves. But consistent with what we've done in the past, bilateral arrangements—some mainly through EDC to date—but from a terms perspective these are newer aircraft, so longer-term leases in most cases.

We strive with these newer aircraft to certainly match up the debt with the lease. That's not going to always be the case because if there's a situation where the economics make sense and it's a mismatch, I will certainly do that.

Interest rates will be very similar to what you would have seen in our disclosure from our current EDC arrangements on the CPA fleet.

Cameron Doerksen

Okay. And I think I saw in the disclosures there that the ATR transaction it looks like you sourced EDC financing on that. I guess maybe I find that a bit unusual. I didn't I guess know that EDC was financing non-Bombardier built aircraft, but maybe you can just comment on your ability to continue to tap EDC financing for aircraft outside of—

Joe Randell

Yeah.

Cameron Doerksen

—Bombardier-built stuff?

Joe Randell

Well, first of all, the ATR aircraft have engines that were built in Canada.

Cameron Doerksen

Right.

Joe Randell

They are Pratt & Whitney engines, et cetera. And our relationship with EDC, we're really a Canadian company that's exporting and doing business around the world, so the support of EDC is for Canadian operators in total, not just the manufacturers, but also other Canadian businesses like ourselves.

Cameron Doerksen

Okay.

Joe Randell

So—

Cameron Doerksen

Is it your—sorry, is it your expectation that maybe you'll continue to be able to tap financing for even aircraft outside of ATR or Bombardier? Like Embraer aircraft would also be financeable?

Joe Randell

Possibly, but we will be exploring all sources of financing. There are a lot of banks generally outside of Canada that are supportive and actively support the aircraft leasing business, primarily European banks, and we're developing relationships there, et cetera.

So EDC going forward, although they've been and they are very supportive—we have a great relationship with EDC—as time goes on, the amount of business that will be with EDC you can expect to probably lessen as we develop relationships with other lenders.

Nathalie Megann

We'd like diversification in our lenders as well.

Joe Randell

Yeah.

Cameron Doerksen

Okay. Makes sense. Maybe just final for me just on, I guess, leverage. You've got, I guess, covenants that sort of separately apply to the Jazz business and Voyageur business. Can you talk about the covenants on the Chorus Aviation Capital? And is there anything in your, I guess, financial agreements that has a covenant that is on, I guess, Chorus corporate? Or is it all just at the subsidiary level?

Nathalie Megann

Yeah. So with CACC, we've made it an objective to kind of keep it at the subsidiary level with no recourse at the Chorus level. And yeah, there are covenants that are specific to CAC that really kind of focus and centre around some of the debt leverages that we see in the industry and making sure that—we've already said we'll intend to be consistent with debt leverage levels that exist in the industry or be that 3 to 4:1 ratio, but certainly fencing the activity at the subsidiary level.

Cameron Doerksen

Okay. Very good. That's all I had. Thanks very much.

Joe Randell

Thank you.

Operator

Once again, if you would like to ask a question, please press *, 1 on your telephone keypad.

And your next question comes from the line of David Tyerman with Cormark Inc. Your line is open. Please go ahead.

David Tyerman — Cormark Inc.

Yes. Good morning. I was wondering if you could break out the other revenue into leasing versus MRO?

Nathalie Megann

So what—so in that other revenue category, you're right, there's the leasing, a third-party leasing piece and then MRO, which would include both Voyageur and Jazz. And then we've actually, as you know, share kind of the incremental margin that we're seeing related to that other revenue as well, a 4.6 million pick-up in the quarter.

I'll say that the top line certainly is going to be driven by more MRO than the EBITDA line, but you can probably, David, if you think about the leasing side, we really only have predominantly the two CRJ1000s that would have been in the first two quarters of the year really driving incremental leasing revenue.

David Tyerman

Okay.

Nathalie Megann

So because remember we announced the ATRs; they're coming in, really, the end of June. So really it is just the two CRJ1000s and some other small stuff on the Dash 8 side. So I think you can with the capital expenditures section really work in to those numbers of the split—

David Tyerman

Right. Okay. You're taking me to my second question. So your—for a round number, 435 million it looks like of expenditures this year, presumably it looks like almost all of that is in the leasing planes. So can you give any metrics when that's fully deployed—revenue, EBITDA—that you would expect to see from that kind of capital spending?

Nathalie Megann

So yeah, for that that CapEx is predominantly the new leasing business. There is some amount in there related to the life extension program on the Dash 8–300s.

David Tyerman

Right.

Nathalie Megann

I think for the year it's actually in the capital commitment section; it's about $14 million or so that would be attributed to the ESP program. So what I will say is the deals that we're seeing are very consistent with what our expectations were. And I think we've shared that when you look to the regional aircraft leasing industry, we're seeing lease rate factors in the 0.8 to 1.1 range. And that … The lower end of that range would be more consistent with newer aircraft, better credits, whereas the higher end of that range you're probably dealing with midlife aircraft.

David Tyerman

Okay—

Nathalie Megann

So that 0.8, 0.9 percent on a monthly basis would drive like a 10 percent, say, lease rate factor of the investment in the aircraft.

David Tyerman

Right. Okay. That's helpful. And then in terms of the financing, so it sounds like you're going to try and nail something down much sooner than—like the goal would be to do much sooner than 12 months, I would assume, since you wouldn't want to push this to the last minute. Is that a fair assumption?

Joe Randell

That is a fair assumption. Yes. Yeah.

David Tyerman

Okay. Okay. I think that's all I've got. Thank you.

Nathalie Megann

Thank you.

Joe Randell

Thank you.

Operator

Your next question comes from the line of Kevin Chiang from CIBC. And your line is open.

Kevin Chiang — CIBC

Thanks. Just a couple of clarifications for me; when you look at—well, it sounds like things are coming in faster on the leasing front—when you look at the absolute size of what Chorus Aviation Capital can be and your total lease portfolio including, let's call it, the CPA fleet, how big do you think this can be? Or how big would you want this to be? It looks like you'll be about 100 after the Fairfax capital. Is there a number you have in mind there? And maybe fleet type as well? Is this still primarily a regional plane turboprop leasing operation? Or do you think about expanding that, given some of the robustness you see in the pipeline?

Joe Randell

Yeah. Well, first of all, it's we're comfortable in the assets that we're playing in now across the different manufacturers, different equipment types, et cetera. And so we're going to remain focused on that. We know that market. That's where we see the opportunities, which is great.

We see the opportunity to grow. It's going to be driven by the amount of capital that we raise and how quickly we do it. And that's what we're really looking at right now. Already we're well up there in terms of in size relative to other lessors, so for us it's going to be more a matter of what we can comfortably take on and with knowing that the opportunity is there.

So we haven't come up with an exact fleet size at this point because it is a function of what the plan is, and that's exactly what we're working on right now.

Kevin Chiang

Okay. That's very helpful. And when you think of, I guess, the next phase of growth as you procure that additional financing and you go out to bring on new aircraft, do some of the terms that you've kind of laid out for us around how you look at matching debt with the lease term, would you follow the same game plan? So for example, I recall when this was first launched a few quarters ago there was a big push on matching the debt with the lease terms, fully amortizing debt, which can sometimes be a little bit punitive—

Joe Randell

Yeah.

Kevin Chiang

—when you look at leasing transactions. Do you look to lessen some of those terms here when you think of the next phase of growth?

Joe Randell

As we grow the business, I think we'll look at balance. And it's really all about finding the right balance.

Kevin Chiang

Okay.

Joe Randell

Sometimes you can get better returns and better use of capital by changing the debt terms to that of the lease. And you have to look at the lessor and what do you feel the lessor will have a continuing use for the aircraft, which generally I think we understand these markets, we understand what's happening in the industry, et cetera. So as time goes on and as you build a diversified portfolio, it gives you the ability to look at different ways of doing things.

I think initially we're being really conservative for sure, et cetera, but some of the better returns can come from being a little less conservative. So that's what we're going to be balancing out here.

Kevin Chiang

That's helpful. Actually last one for me. When I think of this pipeline and I look at the capital you've committed thus far, it's been primarily through taking on existing leases and you did a sales leaseback with Air Nostrum. On the other side of that risk scale there would be, I guess, acquiring aircraft in a sky line (phon), and then going out and leasing those.

Joe Randell

Yeah.

Kevin Chiang

Is there a greater appetite for that as you build up this lease portfolio, and given some of the confidence you're exuding today as it relates to this business?

Joe Randell

Yes. Absolutely. As we gain these relationships and we develop these relationships and we continue to grow, and of course we're building CAC in terms of the team and its reach in the world as well as we speak. And as we build the organization, looking at opportunities like that would certainly be something that we would do.

And if you look at the industry itself and the existing lessors that are out there, this is where they've achieved some of the most attractive returns. And so we would—we'll continue to look at that, but I think we're very pleased with the approach that we've taken so far by bringing these leases across and being able to achieve good returns. But as we build it we'll start looking at different ways of building and strengthening the business.

Kevin Chiang

Thank you very much.

Operator

Again, if you would like to ask a question, press *, then the number 1 on your telephone keypad.

There are no further questions in the queue at this time. I turn the call back over to Natalie.

Nathalie Megann

Thank you very much, Jodie, and thank you, everyone, for your time today. And wish you a pleasant end of the week.

Operator

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

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