BCP Research: Copa Holdings S.A. - New Convertible Boosts a Strong Balance Sheet

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Summary: Yesterday Copa Holdings S.A., an international Panama based airline, issued a US$350 mm 5-year sr. unsecured convertible bond, with a 4.5% coupon and April 15, 2025 maturity. The company's business model is predominantly hub and spoke from its Panama hub, connecting destinations throughout the Americas with an overwhelmingly international focus. Operations at the Panama hub are currently suspended as a result of the COVID crisis, with an expected return to service in June 2020 (per mgmt.). While the timeline for recovery in demand is quite uncertain, Copa maintains a very strong balance sheet relative to Latin American peers, which is further boosted by the recent offering. Copa benefits from low debt and cash lease costs thanks to its primarily single-fleet (Boeing) make-up, comprised of 102 aircraft, 72% of which are owned by the company directly. We estimate Copa has around half the debt per aircraft vs. its closest Latin American peer by fleet composition.

We have conducted cash burn estimates for each member of its peer group (five Latin America based airlines), as published our COVID-19 Focus List and summarized below, but have yet to do so for Copa. However, the company estimated they would burn around US$765 mm in cash (US$85 mm/month) between April – December 2020 and, at first glance, management's estimate appears credible. We identify US$1.7 bn in pro forma liquidity and estimate US$1 bn in cash burn if operations were to be grounded for twelve months.

The airline appears well positioned for a slower return to demand than other peers with more domestic exposure. Moreover, the shares look very cheap on an absolute basis and vs. peers based on historic results. While we can't say a June restart is "priced in", in general, the timeline for global travel recovery appears to be extending. Amidst this uncertainty, we think the Copa converts look attractive on a swap rather than outright basis. At pricing, implied vol on the conversion option is ~40% vs over 100% realized and over 70% in the listed options market. The implied credit spread of 1,000 bps appears priced off US based carriers (middle of the pack, roughly) as nothing readily compares in the Latam universe. Given the strength of balance sheet, things would have to deteriorate significantly to test the bond floor in our view. The convert is a very tempting way to play recovery in travel demand. As expectations on demand recovery evolve, we will follow the name and look for an opportune entry point for an outright position.

Description	Coupon	Maturity	Amt Out (US$ MM)	Mid Price	Mid YTM	Conv. Price	CPA Price
CPA	4.5	4/15/2025	350	100.0	4.5%	51.66	41.33

** Prices sourced from BBG as of 4/28/2020*

<u>Description of New Convertible Notes:</u>

- **Issuer:** Copa Holdings S.A.
- **Amount:** US$350 mm (with option to issue an additional US$52.5 mm)
- **Rank:** Senior Unsecured
- **Interest:** 4.5% S/A (April 15th & Oct. 15th) beginning October 15th 2020
- **Maturity:** April 15th 2025
- **Conversion Rights:**
    - o Convertible on June 30th 2020 or thereafter into Class A common stock <u>if</u> common stock exceeds 130% of conversion price for at lease 20 of 30 consecutive or non-consecutive trading days
    - o Convertible at maturity on October 15th 2024 until the close of business on the second scheduled trading day immediately before the maturity date

- **Settlement:** Class A common shares, cash or a combination of the two at Copa's discretion
- **Optional redemption**: Copa can redeem any or all bonds at par + accrued unpaid interest from April 18th 2023 through 41 scheduled trading days prior to maturity if last reported sales price per share of common stock exceeds 130% of the conversion price for 20 non-consecutive trading days
- **Qualified Re-opening:** Ability to issue additional notes under the indenture under identical terms to the offering
- **Use of proceeds:** Est. US$342.9 mm in proceeds used for general corporate purposes. Excludes placing, investing or economically utilizing proceeds in Panama
- **Governing Law:** State of New York
- **Company Governance:** Panamanian Law

Comparable Airline Credits:

US$MM	Aeromex	Avianca	Azul	Copa	Gol	Latam
Ticker	AERMEX	PFAVH	AZULBZ	CPA	GOLLBZ	LTMCI
Coupon	7.00%	9.00%	5.88%	4.5%	3.75%	6.88%
Interest Payment Frequency	S/A	S/A	S/A	S/A	S/A	S/A
Maturity	2/5/2025	5/10/2023	10/26/2024	4/15/2025	7/15/2024	4/11/2024
Amount (US$MM)	400	484	400	350	425	700
Rating	B3 *-/ B+/ -	-/ CCC/ CCC- *-	B2 *-/ B+/ B *-	TBD	B2*-/ -/ -	-/ B+/ B+ *-
Rank	Sr Unsecured	1st lien	Sr Unsecured	Sr Unsecured	Sr Unsecured	Sr Unsecured
Mid Price (4/27/2020)	35.5	15.6	59.1	100.0	48.2	43.7
Mid YTM (4/27/2020)	36.5%	100.8%	20.1%	4.5%	23.9%	20.0%
	Aeromex	**Avianca**	**Azul**	**Copa**	**Gol**	**Latam**
Equity Ticker	AEROMEX*	AVH	AZUL	CPA	GOL	LTM
Share px (4/27/2020)	0.32	0.89	7.42	41.33	3.96	3.96
Market Cap (US$MM)	291	136	1,538	1,747	1,011	1,874
	FY19	FY19	FY19	FY19	FY19	FY19
Load Factor (%)	**83.0%**	**81.7%**	**83.4%**	**84.8%**	**82.0%**	**83.1%**
Revenue	**3,572**	**4,615**	**2,105**	**2,707**	**3,512**	**10,431**
EBITDA	**776**	**787**	**914**	**718**	**1,072**	**2,212**
EBITDAR margin	22%	17%	43%	27%	31%	21%
Capex	(240)	(268)	(249)	(62)	(227)	(1,277)
Interest paid	(186)	(275)	(179)	(28)	(121)	(551)
Taxes paid	(14)	(46)	(0)	(43)	(58)	(45)
Payments of finance lease liabilities	(651)	0	(407)	(103)	(410)	(399)
Working Capital	100	(153)	47	18	(77)	375
FCF	**(215)**	**46**	**125**	**499**	**179**	**315**
Gross Debt	**3,411**	**4,856**	**3,882**	**1,360**	**3,588**	**10,416**
Loans & Borrowings	1,905	3,658	874	1,055	2,086	7,244
Lease Liabilities	1,506	1,199	3,008	305	1,502	3,172
Cash and Equivalents	**369**	**342**	**425**	**851**	**755**	**1,073**
Net Debt	**3,043**	**4,514**	**3,457**	**509**	**2,833**	**9,343**
LTM Gross Leverage	**4.4x**	**6.2x**	**4.2x**	**1.9x**	**3.3x**	**4.7x**
LTM Net Leverage	**3.9x**	**5.7x**	**3.8x**	**0.7x**	**2.6x**	**4.2x**
TEV (US$MM)	**3,334**	**4,451**	**4,995**	**2,256**	**3,986**	**11,216**
TEV/EBITDAR	**4.3x**	**5.7x**	**5.5x**	**3.1x**	**3.7x**	**5.1x**
TEV/FCF	**(15.5x)**	**96.9x**	**40.1x**	**4.5x**	**22.3x**	**35.7x**

** Prices sourced from BBG as of close 4/27/2020*

<u>COVID-19 Impact as reported by Management:</u>

- **Suspended Flights:**
  - Panama: International flights to Panama suspended until May 22nd 2020 and entry of non-Panamanian citizens prohibited until further notice
    - Estimated return to operations of June 1st 2020, if travel restrictions in Panama not extended, with expectation of ongoing negative impact of weaker demand
  - Colombia: International and domestic travel into and out of Colombia prohibited until May 30th 2020
  - Brazil: Most non-residents prohibited from entry until April 29th 2020
  - Most non-residents prohibited from entry until May 15th 2020
  - Argentina: Commercial flights suspended through September 2020
- **Operations:**
  - As of March 2020, ASKs down 35.7% y/y and revenue passenger miles down 42.4% y/y, with a load factor of 73.4% (-9.9pp y/y)
  - Non-essential capex and fixed expenses cut, in addition to the acceleration of collection of accounts receivable and negotiation of extended payment terms with suppliers
  - Capex (excl. mandatory aircraft maintenance) suspended for FY20
  - Estimated US$85 mm in cash burn/month between April – December of 2020 (assumes 0% operating capacity and US$0 ticket sales proceeds)
    - Assumes aircraft taken during course of 2020 financed with guarantees from Export-Import Bank (“ExIm Bank”) and such delivery will result in a net cash benefit as a result of return of such pre delivery payments and assumption they will obtain financing w/ guarantees from ExIm Bank, which is currently not committed
    - Also assumes half traffic liabilities (cash refunds to customer deposits reported as “air traffic liabilities” refunded to customers and further reduction of labor-related expenses and other costs as a result of contract renegotiations with suppliers
  - Negotiations with Boeing relating to 737 MAX aircraft ongoing
- **Capacity:**
  - All planned capacity cancelled for April and May 2020, with commercial flights ceased March 22nd 2020
  - June 2020 capacity cut to 12% (measured by ASM) compared to June 2019
- **Access to Liquidity/ Capital:**
  - US$1,130 mm in cash, long-term and short-term investments at March 31st 2020
  - US$145 mm in unsecured lines of credit with local/regional banks drawn on March 2020
  - US$150 mm in undrawn incremental committed lines of credit established in April 2020
  - Currently in discussions to enter secured RCF backed by unencumbered assets (~US$600 mm book value of aircraft, engines, aircraft spare parts and simulators)

<u>Preliminary 1Q20 Results:</u>

- Revenues of US$595.5 mm, down 11.4% y/y
- Operating profit of US$98.7 mm with 16.6% operating margin
- US$1,505 mm in debt comprised of US$1,055 mm in secured debt, US$145 mm in lines of credit with regional banks, and US$305 mm in lease liabilities
  - The company expects to incur US$350 – 402.5 mm of additional debt as a result of the convertible offering
- US$1,130 bn in cash comprised of US$304 mm in cash and cash equivalents and US$827 mm in long-term and short-term investments
  - In March 2020, Copa borrowed US$145 mm from unsecured loan facilities, maturing March 2021
  - In April 2020, the company added US$150 mm in new unsecured and fully committed credit facilities (undrawn)

4Q19 Financial and Operating Results:

- At year-end 2019 the company had a consolidated fleet of102 aircraft comprised of 6 Boeing 737 MAX9s, 68 Boeing 737-800s, 14 Boeing 737-700s and 14 Embraer 190s
    - The company plans to sell the remaining 14 Embraer 190s over the next two years. As such, these assets are classified as held-for-sale on the balance sheet.
- Load Factor increased 250 bps y/y but decreased 31 bps q/q to 85.3%
- Revenue of US$682 mm increased 4% y/y despite a 4.6% capacity contraction and as a result of increased passenger revenue, but decreased 4% q/q
- Adjusted EBITDA increased 38% y/y to US$38 mm with a 26% margin on stronger unit revenues and lower jet fuel prices
    - Adjusted EBITDA includes a US$89 mm impairment charge related to the 14 Embraer 190s classified as held for sale
- Gross Debt was US$1,360 mm, 5% lower q/q
    - Consolidated debt of US$1.06 bn (excl. intercompany liabilities) at December 2019 consisting primarily of aircraft acquisition debt
    - As of December 31, 2019 JOLCO financed debt outstanding was $828.8 million, used to finance the purchase of its Boeing 737s
- Net Debt was 24% lower sequentially at US$509 mm
- Cash and equivalents were 12% higher q/q at US$851 mm
- Liquidity, which includes cash and equivalents, short-term investments and accounts receivable increased 9% q/q to US$981 mm
- Cash/Revenue and Liquidity/Revenue were robust at 31% and 36%, respectively

Copa Holdings S.A. (US$MM)	4Q 2019	3Q 2019	4Q 2018	y/y	q/q
	Unaudited	Unaudited	Unaudited		
Load Factor	**85.3%**	**85.6%**	**82.8%**	**250 bps**	**(31 bps)**
Revenue	**682**	**708**	**656**	**4%**	**(4%)**
EBIT	**18**	**133**	**(126)**	**(114%)**	**(87%)**
Depreciation & Amortization	70	73	66	6%	(3%)
EBITDA	**88**	**206**	**(60)**	**(247%)**	**(57%)**
EBITDA margin	*12.9%*	*29.1%*	*(9.1%)*	-	-
Fleet impairment	89	-	189	(53%)	-
Adjusted EBITDA	**178**	**206**	**129**	**38%**	**(14%)**
Adjusted EBITDA margin	*26.0%*	*29.1%*	*19.6%*	*643 bps*	*(304 bps)*
Cash and equivalents	**851**	**761**	**722**	**18%**	**12%**
Cash and equivalents	159	225	156	2%	(30%)
Short-term investments	692	536	566	22%	29%
Accounts receivable	**130**	**141**	**116**	**12%**	**(8%)**
Liquidity	**981**	**902**	**838**	**17%**	**9%**
Gross Debt	**1,360**	**1,432**	**1,663**	**(18%)**	**(5%)**
Loans and borrowings	1,055	1,101	1,287	(18%)	(4%)
Lease liabilities	305	331	376	(19%)	(8%)
Net Debt	**509**	**671**	**941**	**(46%)**	**(24%)**
LTM Adj. Gross Leverage	**1.9x**	**2.1x**	**2.7x**	**(0.8x)**	**(0.2x)**
LTM Adj. Net Leverage	**0.7x**	**1.0x**	**1.5x**	**(0.8x)**	**(0.3x)**
Cash / Revenue	**31%**	**28%**	**27%**	**446 bps**	**304 bps**
Liquidity / Revenue	**36%**	**34%**	**31%**	**492 bps**	**258 bps**

FY19 Financial and Operating Results:

- Load Factor increased 144 bps y/y to 84.8%
- Revenue was relatively flat at US$2,707 mm

- Adjusted EBITDA increased 44% y/y to US$718 mm with a margin of 26.5% on stronger unit revenues and lower jet fuel prices
- Free cash flow was US$499 mm, up 41% y/y on strong adjusted EBITDA and WK generation
    - Capex decreased 48% y/y to US$62 mm
    - Interest payments remained stable at US$28 mm
    - Taxes paid were 11% higher y/y at US$43 mm
    - Lease liabilities decreased 3% y/y to US$103 mm
    - Working capital generation of US$18 mm decreased 11% y/y

Copa Holdings S.A. (US$MM)	FY19	FY18	y/y
	Audited	Audited	
Load Factor	**84.8%**	**83.4%**	**144 bps**
Revenue	**2,707**	**2,678**	**1%**
EBIT	**346**	**159**	**117%**
Depreciation & Amortization	282	277	2%
EBITDA	**628**	**436**	**44%**
EBITDA margin	*23.2%*	*16.3%*	*692 bps*
Fleet impairment	89	189	(53%)
Adjusted EBITDA	**718**	**625**	**15%**
Adjusted EBITDA margin	*26.5%*	*23.3%*	*318 bps*
Capex	(62)	(119)	(48%)
Interest paid	(28)	(28)	1%
Taxes paid	(43)	(39)	11%
FCF (before WK & Lease Liabilities)	**584**	**439**	**33%**
Payments of finance lease liabilities	(103)	(106)	(3%)
FCF (before WK)	**481**	**333**	**44%**
Working capital	18	20	(11%)
FCF	**499**	**353**	**41%**
Cash and equivalents	**851**	**722**	**18%**
Cash and equivalents	159	156	2%
Short-term investments	692	566	22%
Accounts receivable	**130**	**116**	**12%**
Liquidity	**981**	**838**	**17%**
Gross Debt	**1,360**	**1,663**	**(18%)**
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Lease liabilities	305	376	(19%)
Net Debt	**509**	**941**	**(46%)**
LTM Adj. Gross Leverage	**1.9x**	**2.7x**	**(0.8x)**
LTM Adj. Net Leverage	**0.7x**	**1.5x**	**(0.8x)**
Cash / Revenue	**31%**	**27%**	**446 bps**
Liquidity / Revenue	**36%**	**31%**	**492 bps**

South American Airlines COVID-19 Stress Test:

Operationally, we have favored Gol as best positioned among HY Latin American airlines issuers to weather the current environment, based on our liquidity stress test analysis. Low international exposure, low starting leverage, high margins, strong liquidity and the tailwind of the MAX groundings all favor Gol, together with potential government financing, if needed. We currently rate GOLLBZ 3.75% 24s 'Market Outperform' on our Top Picks, which remain cheap to the later dated pari-passu GOLLBZ 7% 25s, and below their bond floor at 48c (24% YTM), offering a virtually free option on the equity. The recent rally in price appears to validate our views. However, further gains may be tempered by uncertainty on the reactivation of the Brazilian travel industry and F/X volatility.

Our next point of focus are the sr. secured PFAVHC 9% 23s, trading at 16c – a completely different risk vs. reward profile. While we don't expect government support, Avianca came into the crisis with strong liquidity. Based on our COVID-19 Airlines Stress Test, assuming demand recovery is realized by 2021, liquidity prior to any external WK financing, deferral lease and interest payments from 2Q-4Q20 would appear sufficient to provide Avianca a fighting chance. The airline has entered into the crisis with significantly weaker margins and an elevated net leverage of 5.7x (4Q19). However, as a result of its recent reprofiling, it also benefits from a strong cash position. At the time of its February 28th 2020 earnings call, the company claimed to have slightly under US$650 mm in cash. IP collateral, though difficult to value, remains key to the airline's operation and should favor bondholders in a restructuring. Thus, we are assessing the sr. secured PFAVH 9% '23s as a potential opportunity for more speculative investors at 16c, more akin to an option bet with perhaps 3x1 upside vs downside.

(See Next Page for Table)

(US$ MM)	Aeromexico					Avianca					Azul					Gol					LATAM				
Country	Mexico					Colombia					Brazil					Brazil					Chile/Brazil				
Ticker	AERMEX					PFAVH					AZULBZ					GOLLBZ					LTMCI				
Coupon	7.00%					9.00%					5.875%					3.75%					6.875%				
Maturity	2/5/25					5/10/23					10/26/24					7/15/2024					4/11/24				
Amt out (US$MM)	400					484					400					425					700				
Rank	Sr. Unsecured					Sr. Secured					Sr. Unsecured					Sr Unsecured					Sr. Unsecured				
Mid Price (4/27/2020)	35.5					15.6					59.1					48.2					44.3				
Mid YTM (4/27/2020)	36.50%					100.84%					20.14%					23.92%					33.19%				
	2018* *	2019	2020	2020	2020	2018* *	2019	2020	2020	2020	2018* *	2019	2020	2020	2020	2018* *	2019	2020	2020	2020	2018* *	2019	2020	2020	2020
Source	Reported	Reported	Consensus	Stress Test	Stress Test	Reported	Reported	Consensus	Stress Test	Stress Test	Reported	Reported	Consensus	Stress Test	Stress Test	Reported	Reported	Consensus	Stress Test	Stress Test		Reported	Consensus	Stress Test	Stress Test
				Base Case	WK Support				Base Case	WK Support				Base Case	WK Support				Base Case	WK Support				Base Case	WK Support
EBITDA	**656**	**777**	**766**	**(184)**	**(184)**	**876**	**774**	**763**	**(45)**	**(45)**	**678**	**919**	**851**	**(17)**	**(17)**	**664**	**1,078**	**914**	**(104)**	**(104)**	**2,249**	**2,212**	**2,225**	**(272)**	**(272)**
EBITDA margin	*18%*	*22%*	*24%*	*(13%)*	*(13%)*	*18%*	*17%*	*18%*	*(2%)*	*(2%)*	*27%*	*32%*	*32%*	*(2%)*	*(2%)*	*21%*	*31%*	*30%*	*(8%)*	*(8%)*	*22%*	*21%*	*21%*	*(5%)*	*(5%)*
Lease & interest Paid / LTM Revenue	**9%**	**23%**	**26%**	**60%**	**14%**	**4%**	**29%**	**32%**	**60%**	**14%**	**22%**	**20%**	**28%**	**69%**	**17%**	**12%**	**15%**	**15%**	**37%**	**9%**	**9%**	**9%**	**9%**	**18%**	**4%**
Cash / Revenue	**12%**	**10%**	**10%**	**(54%)**	**(9%)**	**6%**	**7%**	**2%**	**(38%)**	**8%**	**18%**	**15%**	**2%**	**(60%)**	**(9%)**	**14%**	**12%**	**7%**	**(29%)**	**1%**	**10%**	**10%**	**11%**	**(11%)**	**4%**
Liquidity / Revenue	**21%**	**19%**	**18%**	**(42%)**	**4%**	**12%**	**13%**	**8%**	**(32%)**	**15%**	**29%**	**25%**	**11%**	**(46%)**	**5%**	**21%**	**21%**	**15%**	**(16%)**	**13%**	**22%**	**22%**	**23%**	**6%**	**21%**
Net Debt	**2,698**	**3,008**	**3,267**	**4,330**	**4,330**	**4,667**	**4,514**	**4,770**	**5,713**	**5,713**	**2,578**	**3,452**	**3,781**	**4,488**	**4,488**	**2,849**	**3,164**	**3,386**	**3,921**	**3,888**	**9,072**	**9,343**	**9,217**	**10,989**	**10,989**
Net Leverage	**4.1x**	**3.9x**	**5.7x**	**NM**	**NM**	**5.3x**	**5.8x**	**7.5x**	**NM**	**NM**	**3.8x**	**3.8x**	**5.3x**	**NM**	**NM**	**4.3x**	**2.9x**	**4.3x**	**NM**	**NM**	**4.0x**	**4.2x**	**4.9x**	**NM**	**NM**
Pro-Forma Net Leverage	**6.6x**	**5.6x**	**5.7x**	**NM**	**NM**	**6.5x**	**7.4x**	**7.5x**	**NM**	**NM**	**6.6x**	**4.9x**	**5.3x**	**NM**	**NM**	**5.4x**	**3.4x**	**4.3x**	**NM**	**NM**	**4.9x**	**5.0x**	**4.9x**	**NM**	**NM**

** Prices sourced from BBG as of close 4/27/2020*

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MEANINGS OF RATINGS

Top Picks Universe
"Market Outperform" – The bond's total return is expected to exceed the total return of the J.P. Morgan Corporate Emerging Markets Bond Index series ("CEMBI") Broad Diversified High-Yield Index over the next 3 – 6 months.

"Market Perform" – The bond's total return is expected to be in line with the total return of the CEMBI Broad Diversified High-Yield Index over the next 3 – 6 months.

"Market Underperform" – The bond's total return is expected to be below the total return of the CEMBI Broad Diversified High-Yield Index over the next 3 – 6 months.

"Not Rated" or no comment – Currently, the analyst does not have adequate conviction about the bond's total return relative to the CEMBI Broad Diversified High-Yield Index over the next 3 – 6 months.

Quasi Sovereign Universe
"Market Overweight" – The spread of the bond to its similarly duration sovereign controller bond is expected to decrease over the next 3 – 6 months.

"Market Weight" – The spread of the bond to its similarly duration sovereign controller bond is expected to remain unchanged over the next 3 – 6 months.

"Market Underweight" – The spread of the bond to its similarly duration sovereign controller bond is expected to increase over the next 3 – 6 months.

"Not Rated" or no comment – Currently, the analyst does not have adequate conviction about the bond's spread to its similarly duration sovereign controller bond over the next 3 – 6 months.

High Octane Universe

"Speculative Buy" – Bonds that in our view have an equity investment risk profile and we think risk/return is significantly skewed to the upside

"Positive" – Bonds that in our view have an equity investment risk profile and we think risk/return is skewed to the upside

"Neutral" – Bonds that in our view have an equity investment risk profile and we think risk/return is balanced

"Negative" – Bonds that in our view have an equity investment risk profile and we think risk/return is skewed to the downside

"Speculative Sell" – Bonds that in our view have an equity investment risk profile and we think risk/return is significantly skewed to the downside

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