BCP Research: Copa Holdings S.A. - 1Q20 Results - Soft w/ Robust Liquidity - Maintain 'Neutral'

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Summary: International Panama based airline, Copa released soft 1Q20 results with load factor, revenue and adj. EBITDA lower y/y and sequentially. Results contracted primarily at quarter-end as a result of the COVID-19 crisis and the Panamanian government's subsequent suspension of international flights through May 22nd 2020. The company did not disclose cash flow details. However, Copa guided to US$85 mm/month (US$630 mm for the remainder of FY20) in cash burn, including 50% ticket reimbursement, under a zero-recovery environment, and US$70 mm/month (US$765 mm for the remainder of 2020) in cash burn, including ticket reimbursement, were operations to return to service on June 1st 2020.

As stated in our previous note, the company's business model relies heavily on its Panama hub with an overwhelmingly international focus. Copa has estimated capacity would be 12% of June 2019, building to 40% of capacity by year-end 2020, were operations to resume on June 1st. While we can't say a June restart is "priced in", in general, the timeline for global travel recovery appears to be extending. However, 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. This positions the airline well for a slower return to demand than other peers, even those with more domestic exposure.

Furthermore, Copa's balance sheet remains the strongest among airlines in the region with 38% cash to LTM revenue and 40% liquidity to LTM revenue at 1Q20. This excludes proceeds received in 2Q20 from the new US$150 mm undrawn credit facility and US$350 mm from the issuance of convertible bonds, as well as an estimated US$200-300 in potential liquidity from unencumbered assets and Boeing compensation (est. US$450 mm+ for 2Q20). Altogether, this would imply pro-forma liquidity of US$1.9-2.0 bn vs. the company estimated US$630 – 765 mm in cash burn for the remainder of the year – more than sufficient to cover costs for the remainder of FY20, even under a zero recovery scenario

The convert remains a highly tempting way to play recovery in travel demand. We continue to follow the name and look for an opportune entry point for an outright position as expectations on demand recovery evolve. In the interim, we view Copa converts as an attractive swap, with shares continuing to look very cheap on an absolute basis and vs. peer (based on historic results).

	Amt Out (US$ MM)	Mid Price	Mid YTW	Implied Vol	Cheapness (par)	Delta (par)	Conv. Price	CPA US Price
CPA 4.5% 4/15/2025	350	99.0	4.73%	32.18%	6.44%	88.0%	$51.66	$42.62

** Source: Equity information sourced from Bloomberg. Convertible pricing as of May 11th 2020.*

<u>1Q20 Financial and Operating Results:</u>

- At 1Q20 the company had a consolidated fleet of 102 aircraft comprised of 6 Boeing 737 MAX9s, 68 Boeing 737-800s, 14 Boeing 737-700s and 14 Embraer 190s

- The company is evaluating the plans to sell its remaining 14 Embraer 190s over the next two years. These assets are currently classified as held-for-sale on the balance sheet

- Passenger traffic decreased 16.3% y/y and capacity contracted 14.5% as a result of the COVID-19 pandemic
- This resulted in a load factor of 81.5%, 180 bps lower y/y and 378 bps lower q/q
    - The company estimates, were operations to begin again on June 1st 2020, that capacity would be 12% of June FY19, building to 40% of capacity by year-end 2020
        - International flight suspension is expected to be lifted on May 22nd 2020, pending further extension
- Revenue of US$595 mm decreased 11% y/y and 13% q/q
- Adjusted EBITDA decreased 9% y/y and 7% to US$165 mm with a 28%
- Free cash flow details were not disclosed, though the company has suspended/deferred all non-essential capex for the remainder of FY20
    - Were the company to continue under its current zero-revenue environment, it estimates approximately US$85 mm/month cash burn (assuming 50% reimbursement sales liability), US$680 total, for the remainder of 2020
    - Should the company return to operations June 1st it estimates cash outflow of US$70 mm/month (assuming 50% reimbursement sales liability), US$630 total, for the remainder of 2020
- Gross Debt was US$1,4670 mm, 8% higher q/q
- Net Debt was 11% lower sequentially at US$454 mm
- Cash and equivalents were 19% higher q/q at US$1,013 mm
    - In March 2020, Copa borrowed US$145 mm from unsecured loan facilities, maturing March 2021
    - US$74 mm in expendable parts and supplies are not included in our calculated liquidity balance, which would bring the total liquidity to the company's stated US$1.13 bn
- Liquidity, which includes cash and equivalents, short-term investments and accounts receivable increased 8% q/q to US$1,064 mm
    - The company has also stated it has an additional US$600 mm book value in unencumbered assets (19 unencumbered aircraft, 9 spare engines, and the entirety of its aircraft spare parts inventory), which it believes could yield an addition US$200-300 mm in additional potential sources of liquidity
- LTM adj. net leverage was 0.6x
- Cash/Revenue and Liquidity/Revenue were robust at 38% and 40%, respectively

Copa Holdings S.A. (US$MM)	1Q20	4Q19	3Q19	2Q19	1Q19	y/y	q/q	FY19	FY18	y/y
	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited			Audited	Audited	
Load Factor	**81.5%**	**85.3%**	**85.6%**	**85.1%**	**83.3%**	**(180 bps)**	**(378 bps)**	**84.8%**	**83.4%**	**144 bps**
Revenue	**595**	**682**	**708**	**645**	**672**	**(11%)**	**(13%)**	**2,707**	**2,678**	**1%**
EBIT	**99**	**18**	**133**	**83**	**113**	**(12%)**	**454%**	**346**	**159**	**117%**
Depreciation & Amortization	66	70	73	71	68	(3%)	(6%)	282	277	2%
EBITDA	**165**	**88**	**206**	**153**	**181**	**(9%)**	**87%**	**628**	**436**	**44%**
EBITDA margin	*27.7%*	*12.9%*	*29.1%*	*23.7%*	*26.9%*	-	-	*23.2%*	*16.3%*	*692 bps*
Fleet impairment	-	89	-	-	-	-	-	89	189	(53%)
Adjusted EBITDA	**165**	**178**	**206**	**153**	**181**	**(9%)**	**(7%)**	**718**	**625**	**15%**
Adjusted EBITDA margin	*27.7%*	*26.0%*	*29.1%*	*23.7%*	*26.9%*	*82 bps*	*167 bps*	*26.5%*	*23.3%*	*318 bps*
Capex	n/a	n/a	n/a	n/a	n/a	-	-	(62)	(119)	(48%)
Interest paid	“ “	“ “	“ “	“ “	“ “	-	-	(28)	(28)	1%
Taxes paid	“ “	“ “	“ “	“ “	“ “	-	-	(43)	(39)	11%
FCF (pre. WK & Lease Liabilities)	“ “	“ “	“ “	“ “	“ “	**-**	**-**	**584**	**439**	**33%**
Finance lease liabilities paid	“ “	“ “	“ “	“ “	“ “	-	-	(103)	(106)	(3%)
FCF (before WK)	“ “	“ “	“ “	“ “	“ “	**-**	**-**	**481**	**333**	**44%**
Working capital	“ “	“ “	“ “	“ “	“ “	-	-	18	20	(11%)
FCF	“ “	“ “	“ “	“ “	“ “	**-**	**-**	**499**	**353**	**41%**
Cash and equivalents	**1,013**	**851**	**761**	**749**	**768**	**32%**	**19%**	**851**	**722**	**18%**
Cash and equivalents	340	159	225	226	212	60%	114%	159	156	2%
Short-term investments	673	692	536	523	556	21%	(3%)	692	566	22%
Accounts receivable	**51**	**130**	**141**	**162**	**159**	**(68%)**	**(61%)**	**130**	**116**	**12%**
Liquidity	**1,064**	**981**	**902**	**912**	**928**	**15%**	**8%**	**981**	**838**	**17%**
Gross Debt	**1,467**	**1,360**	**1,432**	**1,595**	**1,728**	**(15%)**	**8%**	**1,360**	**1,663**	**(18%)**
Loans and borrowings	1,169	1,055	1,101	1,242	1,357	(14%)	11%	1,055	1,287	(18%)
Lease liabilities	297	305	331	353	371	(20%)	(2%)	305	376	(19%)
Net Debt	**454**	**509**	**671**	**846**	**960**	**(53%)**	**(11%)**	**509**	**941**	**(46%)**
LTM Adj. Gross Leverage	**8.9x**	**1.9x**	**2.1x**	**n/a**	**n/a**	**-**	**7.0x**	**1.9x**	**2.7x**	**(0.8x)**
LTM Adj. Net Leverage	**2.8x**	**0.7x**	**1.0x**	**n/a**	**n/a**	**-**	**2.0x**	**0.7x**	**1.5x**	**(0.8x)**
Cash / Revenue	**38%**	**31%**	**28%**	**n/a**	**n/a**	**-**	**706 bps**	**31%**	**27%**	**446 bps**
Liquidity / Revenue	**40%**	**36%**	**34%**	**n/a**	**n/a**	**-**	**421 bps**	**36%**	**31%**	**492 bps**

<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, with the company expected to receive an estimated US$450 mm+ in pre-delivery deposits, per earnings call
- **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$1.0 bn 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 a US$200-300 mm secured RCF backed by unencumbered assets (~US$600 mm book value of aircraft, engines, aircraft spare parts and simulators)
  - US$450 mm+ in pre-delivery deposits resulting from the grounding of MAX-8s

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