

## BCP Research: Air Canada (ACACN)- 2Q20 Results-Weak

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*Summary: Canada's largest passenger airline, Air Canada (AirCan) released expectedly weak 2Q20 results, with revenue down and adj. EBITDA turned negative, in line with a sharp reduction in bookings in what is likely the low point for airlines amidst the pandemic. Cash burn of US\$1.4 bn is expected to show only marginal improvement in 3Q20. However, AirCan's US\$6.9 bn in liquidity (65% of LTM revenue), bolstered by significant capital raises in 2Q, is among the highest within our coverage – implying 18 months of liquidity runway with zero demand recovery. While convertible bondholders are deeply subordinated, LTM net leverage remains manageable at 4.4x.*

*Management sees a three year runway to demand recovery, slightly lower than the 4-year industry consensus (IATA). We see a slow pathway to recovery for AirCan, evidenced by its anemic current load factor of 35%, with reliance on international and long haul flights, and widebodies comprising 1/3 of its fleet. We assume 2019 EBITDA of US\$2.5 bn would represent a full recovery (74% upside for the common). AirCan's EV / EBITDA pre crisis multiple trailed peers (2019: 4.5x v. 8.3x peer avg.), likely due to LCC competition and lower growth prospects relative to our EM coverage group. We now see AirCan TEV trading at 3.6x fully recovered EBITDA based on our YE 2020 net debt estimates. Given the risks involved, we think 74% upside over a multiyear time period appears fairly priced and hence remain neutral for an outright position. We continue to favor GOLLBZ 3.75% 24s converts, rated 'Positive' on our High Octane with healthy load factor, domestic-focused routes, fleet flexibility and a virtually free option on the equity upside of nearly 151% vs. fully recovered EBITDA, trading slightly above the bond floor at 54c (22% mid-YTM).*

	Amt (US\$ MM)	Ratings (M/SP/F)	Mid Price	Mid YTM	Rank
ACACN 7.75% 4/15/2021	400	Ba3/ B+/ B+	101.51	5.450%	Sr. Unsecured

	Coupon	Maturity	Amt Out (US\$ MM)	Mid Price	Mid YTM	IVOL	Cheapness (par)	Delta (par)	Conv. Price	ACCN Price	Rank
ACACN	4.0%	7/1/2025	748	107.63	2.34%	37.67%	5.25%	83.61%	\$15.25	\$11.98	Sr. Unsecured

\* Prices sourced from BBG as of August 6<sup>th</sup> 2020

### 2Q20 Operating Results:

- **RPMs and ASMs:** Revenue passenger miles (RPMs) decreased 97% y/y and 96% q/q to 783 mm, while average seat miles (ASMs) decreased 92% y/y and 90% q/q to 2,243 mm, both on reduced bookings as a result of government regulated travel restrictions
- **Passenger load factor** contracted to 34.9%, significantly lower than other airlines in our coverage
- **Yield** increased 35% y/y and 47% q/q due to decline in traffic and changes in traffic mix
  - Yield in 1H20 increased 3% y/y v. traffic decline of 59% y/y
- **PRASM** decreased 44% y/y and 31% q/q to US\$6.6 cents, in line with significant passenger load factor contraction, which was partially offset by increased yield in the quarter
- **CASM** increased 466% y/y and 433% q/q to US\$67.0 cents
- **Adj. CASM**, was US\$55.5 cents (+567% y/y, +496% q/q) and excludes fuel expenses, cost of ground packages at Air Canada and special items
- **Fleet** totaled 211 in 2Q20, made up of 77 wide-body and 100 narrow-body at AirCan, and 34 narrow-body at Air Canada Rouge
  - Additional fleet: AirCan has 137 additional Embraer and Bombardier aircraft, which are operated on behalf of AirCan through capacity purchase agreements with Jazz, Sky Regional and other regional airlines under the Air Canada Express banner
  - Narrow-body fleet at AirCan includes 24 Boeing 737 MAX, which have been grounded since March '19

- The company has reduced its original order for 61 Boeing 737 MAX by 11 MAX 9s as of 1Q20
- In 2Q20, AirCan retired 50 older aircraft from its fleet, as part of a planned total reduction of 79 aircraft
  - The 50 retired aircraft include fourteen (14) Embraer 190s, thirty (30) Boeing 767s and six (6) Airbus A319
- Aircan has a firm order for 45 Airbus 220-300 aircraft, of which seven (7) have been received to-date, including six (6) delivered in 1H20, with an additional eight (8) expected to be delivered in 2H20
- In addition, the airline received two (2) Airbus A330-300 at AirCan and one (1) Airbus A319 in 1H20, with an additional Airbus A330 expected to be delivered in 2H20

Air Canada (USD MM)	2Q20	1Q20	4Q19	3Q19	2Q19	y/y	q/q
RPM (mm)	783	17,507	21,403	27,954	23,463	(97%)	(96%)
ASM (mm)	2,243	23,511	26,431	32,457	27,910	(92%)	(90%)
Passenger Load Factor (%)	34.9%	74.5%	81.0%	86.1%	84.1%	(4,916 bps)	(3,955 bps)
Yield (cents)	19.1	12.9	14.3	14.0	14.1	35%	47%
PRASM (cents)	6.6	9.7	11.5	12.0	11.8	(44%)	(31%)
CASM (cents)	67.0	12.6	12.5	10.7	11.8	466%	433%

### **2Q20 Financial Results:**

- **Revenue** decreased 90% y/y and 86% q/q to US\$380 mm, again in line with government regulated travel restrictions the anticipated low point of the COVID-19 pandemic
- **Adj. EBITDA turned** negative US\$600 mm v. US\$700 mm in 2Q19 and US\$50 mm in the prior quarter
  - Adjustments include:
    - An impairment of US\$238 mm, reflecting the fair value less costs of the accelerated retirement of 79 older aircraft (Boeing 767, Airbus A319, Embraer 190) from AirCan's fleet, and previously capitalized costs incurred for technology based intangible assets, which have now been cancelled
    - A workforce reduction provision of US\$81 mm, reflecting estimated termination and severance costs related to the layoff of ~20,000 employees in 2Q20.
    - A US\$146 mm gain, relating to AirCan's participation in the Canada Emergency Wage Subsidy (CEWS), net of cost of CEWS eligible inactive employees. AirCan's CEWS participation has been extended to Dec. 2020 (orig. June 2020), and US\$3 mm in other gains
  - Excluding adjustments, EBITDA would have been negative US\$771 mm
- **Cash burn** of US\$1,398 mm was driven primarily by negative adj. EBITDA, which outweighed significant reductions to lease and tax payments, capex and working capital outflow
  - Lease payments decreased 46% q/q to US\$194 mm
  - Interest payments were 24% higher q/q at US\$97 mm
  - The company paid no taxes in 2Q20
  - Capex was cut by 42% q/q to US\$153 mm
  - Working capital outflow was US\$183 mm, a 66% reduction q/q

Air Canada (USD MM)	2Q20	1Q20	4Q19	3Q19	2Q19	y/y	q/q
<b>Revenue</b>	<b>380</b>	<b>2,647</b>	<b>3,377</b>	<b>4,194</b>	<b>3,633</b>	<b>(90%)</b>	<b>(86%)</b>
<b>Operating Income</b>	<b>(1,122)</b>	<b>(308)</b>	<b>112</b>	<b>722</b>	<b>322</b>	-	<b>264%</b>
Depreciation & amortization	351	358	400	390	377	(7%)	(2%)
<b>EBITDA</b>	<b>(771)</b>	<b>50</b>	<b>512</b>	<b>1,112</b>	<b>700</b>	-	-
<i>EBITDA margin</i>	<i>(203%)</i>	<i>2%</i>	<i>15%</i>	<i>27%</i>	<i>19%</i>	-	-
Impairments	238	-	-	-	-	-	-
Workforce reduction provision	81	-	-	-	-	-	-
Canada emergency wage subsidy	(146)	-	-	-	-	-	-
Other	(3)	-	-	-	-	-	-
<b>Adj. EBITDA</b>	<b>(600)</b>	<b>50</b>	<b>512</b>	<b>1,112</b>	<b>700</b>	-	-
<i>Adj. EBITDA margin</i>	<i>(158%)</i>	<i>2%</i>	<i>15%</i>	<i>27%</i>	<i>19%</i>	-	-
Cash lease	(194)	(362)	(212)	(208)	(214)	(9%)	(46%)
Interest paid	(97)	(78)	(95)	(87)	(102)	(5%)	24%
Taxes paid	-	(65)	(12)	(13)	(17)	-	-
Capex	(153)	(265)	(193)	(227)	(422)	(64%)	(42%)
Working capital	(183)	(532)	(65)	(334)	282	-	(66%)
<b>Free Cash Flow</b>	<b>(1,398)</b>	<b>(1,252)</b>	<b>(66)</b>	<b>242</b>	<b>227</b>	-	<b>12%</b>

- **Cash** increased 40% q/q to US\$6,367 mm, with cash to LTM revenue reaching 60%, primarily as a result of significant capital raises
- **Liquidity** expanded 38% q/q to US\$6,866 mm, with liquidity to LTM revenue of 65%
  - We highlight BCP's evaluation of liquidity across all airlines includes cash, ST investments and ST accounts receivable
  - AirCan's reported available liquidity was US\$6,781 mm, including cash, ST investments and LT investments (1Q20: US\$4,854 mm)
  - The company has also identified ~US\$1,840 (CAD 2.5 bn) of unencumbered assets (excl. Aeroplan and AirCan Vacations) as of end-2Q20, which could provide additional liquidity via financing arrangements
- **Gross Debt** increased 30% q/q to US\$10,312 mm, following securing of loans and the issuance of convertible and senior secured notes
  - April '20:
    - Concluded a US\$600 mm 364-day term loan, secured by aircraft and spare engines
    - Concluded US\$1,070 mm (CAD 788 mm) in bridge financing for 18 Airbus A220 aircraft, which it expects to replace with longer-term secured financing in 2H20, secured by the 18 Airbus A220s
  - June '20:
    - Issued an aggregate US\$748 mm in USD-denominated senior unsecured convertible notes, as well as 35.4 mm Class A/Class B shares
    - Issued an aggregate CAD-denominated 840 mm (US\$619 mm) in 9% 2024 2<sup>nd</sup> lien secured notes sold at 98% par via private offering, and secured by certain real-estate interests, ground services equipment, airport slots, gate leaseholds and routes
    - Issued an aggregate US\$315 mm (CAD 426 mm) in 10.5% 2026 Class C EETCs at 95.002% par. The tranche ranks junior to previously issued Series 2015-1, 2015-2 and 2017-1 EETCs
- **Net debt** increased 16% q/q to US\$3,945 mm
- **LTM net leverage** expanded to 4.4x on reduced revenues, tempered by capital raises in the quarter

Air Canada (USD MM)	2Q20	1Q20	4Q19	3Q19	2Q19	y/y	q/q
Cash and Equivalents	3,749	1,926	2,878	2,948	3,287	14%	95%
ST Investments	2,619	2,634	2,878	2,948	3,287	(20%)	(1%)
<b>Cash</b>	<b>6,367</b>	<b>4,560</b>	<b>5,757</b>	<b>5,897</b>	<b>6,574</b>	<b>(3%)</b>	<b>40%</b>
Accounts Receivable	499	422	702	678	797	(37%)	18%
<b>Liquidity</b>	<b>6,866</b>	<b>4,982</b>	<b>6,458</b>	<b>6,575</b>	<b>7,371</b>	<b>(7%)</b>	<b>38%</b>
<b>Gross Debt</b>	<b>10,312</b>	<b>7,958</b>	<b>7,002</b>	<b>7,089</b>	<b>7,174</b>	<b>44%</b>	<b>30%</b>
Aircraft financing	4,568	3,266	3,346	3,477	3,535	29%	40%
Convertible notes	748	-	-	-	-	-	-
Senior secured notes	766	149	152	151	152	405%	415%
Senior unsecured notes	400	418	394	401	398	1%	(4%)
Other USD secured financing	1,168	1,223	558	575	570	105%	(5%)
Other CAD secured financing	147	148	-	-	-	-	(1%)
Lease liabilities	2,647	2,818	2,621	2,555	2,594	2%	(6%)
Unamortized debt issuance costs	(131)	(65)	(68)	(71)	(74)	76%	103%
<b>Net Debt</b>	<b>3,945</b>	<b>3,397</b>	<b>1,246</b>	<b>1,192</b>	<b>600</b>	<b>557%</b>	<b>16%</b>
<b>LTM Revenue</b>	<b>10,598</b>	<b>13,851</b>	<b>14,525</b>	<b>14,262</b>	<b>14,263</b>	<b>(26%)</b>	<b>(23%)</b>
<b>LTM EBITDA</b>	<b>903</b>	<b>2,374</b>	<b>2,760</b>	<b>2,702</b>	<b>2,637</b>	<b>(66%)</b>	<b>(62%)</b>
<b>Gross Leverage</b>	<b>11.4x</b>	<b>3.4x</b>	<b>2.5x</b>	<b>2.6x</b>	<b>2.7x</b>	<b>8.7x</b>	<b>8.1x</b>
<b>Net Leverage</b>	<b>4.4x</b>	<b>1.4x</b>	<b>0.5x</b>	<b>0.4x</b>	<b>0.2x</b>	<b>4.1x</b>	<b>2.9x</b>
<b>Cash to LTM Revenue</b>	<b>60%</b>	<b>33%</b>	<b>40%</b>	<b>41%</b>	<b>46%</b>	<b>1,399 bps</b>	<b>2,715 bps</b>
<b>Liquidity to LTM Revenue</b>	<b>65%</b>	<b>36%</b>	<b>44%</b>	<b>46%</b>	<b>52%</b>	<b>1,310 bps</b>	<b>2,881 bps</b>

### Equity Upside/(Downside) Case:

Cash burn/day assumes flat recovery, using mid-range cash burn estimates for both AirCan (CAD 15-17mm/day) and Gol (BRL 6-12mm/day) adjusted to the average f/x rate for 3Q20 YTD. Liquidity excludes any potential government WK financing (i.e. BNDES) or management identified additional liquidity sources.

Pro-Forma Balance Sheet (US\$MM)	AirCan	Gol
Company Reported Cash Burn / Day (1)	(13)	(2)
Company Reported Cash Burn / Month (1)	(378)	(51)
<b>Months of Liquidity Runway</b>	<b>18</b>	<b>8</b>
2Q20 Cash and Equivalents	6,367	328
+ 2Q20 Accounts Receivable	499	98
<b>Current Est. Liquidity</b>	<b>6,866</b>	<b>427</b>
- Company Est. Monthly Cash Burn Run Rate 2H20 (1)	(2,271)	(306)
<b>Pro-Forma 2020 Cash and Equivalents</b>	<b>4,096</b>	<b>22</b>
+ 2Q20 Accounts Receivable	499	98
<b>Pro-Forma 2020 Liquidity</b>	<b>4,595</b>	<b>120</b>
<b>BCP Est. Pro-Forma 2020 Debt</b>	<b>10,403</b>	<b>3,355</b>
<b>BCP Est. Pro-Forma 2020 Net Debt</b>	<b>6,307</b>	<b>3,333</b>

Enterprise Value (US\$MM)	AirCan	Gol
<b>Current</b>		
Market Cap (8/6/2020)	3,522	1,199
2Q20 Net Debt + Other	3,945	2,926
<b>EV</b>	<b>7,467</b>	<b>4,125</b>
2Q20 LTM EBITDA	903	725
<b>Current EV / EBITDA</b>	<b>8.3x</b>	<b>5.7x</b>
<b>2019 Tear End Trailing</b>		
Market Cap	9,899	3,403
Net Debt	2,540	2,943
<b>EV</b>	<b>12,439</b>	<b>6,347</b>
EBITDA	2,760	1,152
<b>2019 TEV / EBITDA</b>	<b>4.5x</b>	<b>5.5x</b>
<b>Pro-Forma for Full Recovery</b>		
Market Cap (8/6/2020)	3,522	1,199
BCP Est. Pro-Forma Net Debt (1)	6,307	3,333
<b>TEV</b>	<b>9,830</b>	<b>4,532</b>
Fully recovered EBITDA (2)	2,760	1,152
<b>2021 Pro-Forma EV / EBITDA</b>	<b>3.6x</b>	<b>3.9x</b>

(1) Based on company disclosures relating to operations and associated expenses

(2) In line with 2019 EBITDA

- **Equity Upside Case:** Assuming a pathway to more stable profitability, with EV returning to 4.5x and EBITDA to US\$2.8 bn (in line with 2019) alongside flat pro-forma net debt y/y, implies US\$6.3 bn in market cap, or 74% upside from current levels.

Equity Upside (US\$MM)	AirCan	Gol
Current Market Cap (8/6/2020)	3,522	1,199
Current Enterprise Value (EV)	7,467	4,125
Current EV / EBITDA	8.3x	5.7x
<b>Upside Case:</b>		
2019 EV / EBITDA	4.5x	5.5x
Fully Recovered EBITDA (1)	2,760	1,152
EV	12,439	6,347
2021 Pro-Forma Net Debt	6,307	3,333
Implied Market Cap	6,132	3,014
Upside Potential	74%	151%

(1) In line with 2019 EBITDA

(2) BBG consensus 2021 EBITDA

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