# BCP Research: Copa Holdings S.A. (CPA)-2Q20 Results Soft, Liquidity Robust - Upgrade

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*Summary: International Panama-based airline, Copa released mixed 2Q20 results. The sharp decline in revenues outpaced costs reduction efforts, turning adj. EBITDA negative US$40 mm amidst a near 100% reduction in passenger traffic and demand. Reported cash burn was US$77mm/month vs. guidance of US$85mm/month. Cash was stable at US$1.0 bn (52% LTM revenues), as was liquidity (cash and equivalents, ST investments, A/R) at US$1.1 bn (54% LTM revenues) v. US$548 mm in net debt and remarkably low LTM net leverage at 1.1x.*

*Copa plans to restart connectivity operations through the Panama hub, which are not impacted by travel restrictions, by end-August. A gradual full operational restart, pending restrictions, is anticipated by early September. Further consolidation of its single-fleet operations, with the sale of 28 narrow-body aircraft (14 Embraer 190s, 14 Boeing 737-700s) and negotiable MAX delivery terms, should help the company to manage capacity as operations ramp-up. Management expects cash burn to drop to US$66 mm/month in 2H20, including full payment of lease aircraft and debt commitments. In all, Copa appears well positioned to weather this storm, with additional sources to further bolster liquidity, including unencumbered assets and a potential Boeing MAX related settlement.*

*With Copa's strong liquidity and low leverage, the implied credit spread on the converts looks quite wide relative to peers. BBG estimates of US$575 mm EBITDA for 2022 imply 44% equity upside (US$3.0 bn market cap), based on its pre-crisis 7.1x EV/EBITDA multiple. Were Copa to recover to 2019 US$718 mm adj. EBITDA levels at the same 7.1x EV/adj. EBITDA, we estimate 91% upside. A risk is Copa's unique international hub model, which may require a longer runway to recovery as ample and competitive point-to-point capacity exists. Our conservative upside case looks like 2x1 vs. downside to the bond floor, shy of our hurdle for an outright positive rating. But, as stated, we think the credit spread is too cheap to ignore, making a swap position compelling. Even at 900 bps implied spread, which is arguably still quite cheap to peers, we see 17% IVOL on the embedded option v. 95% 100D and 63% IVOL on the listed call. Accordingly, we upgrade CPA '25s to 'Positive – Swap.'*

| | Coupon | Maturity | Amt Out (US$ MM) | Mid Price | Mid YTM | IVOL | Cheapness (par) | Delta (par) | Conv. Price | CPA US Price |
|---|---|---|---|---|---|---|---|---|---|---|
| CPA | 4.5% | 4/15/2025 | 350 | 112.0 | 1.81% | 17.95% | 12.20% | 89.72% | $51.66 | $50.06 |

** Prices sourced from BBG as of close 8/11/2020*

**2Q20 Financial and Operating Results:**

- At 2Q20 the company had a consolidated fleet of 102 aircraft comprised of six Boeing 737 MAX9s, 68 Boeing 737-800s, 14 Boeing 737-700s and 14 Embraer 190s
    - On July 31st, Copa signed a US$79 mm contract to sell its remaining fourteen (14) Embraer 190s, six spare engines and spare parts, which it expects to complete over the next 12 months (prev. 2 years)
        - These assets have been classified as held-for-sale on the balance sheet, with a non-cash non-recurring charge related to the originally recorded US$89 mm in 4Q19, which was adjusted based on a lower sales price, resulting in a US$50 mm non-cash non-recurring loss recorded in 2Q20

- Copa's fourteen (14) Boeing 737-700 have also been placed for sale, resulting in a non-cash non-recurring charge of US$187 mm in 2Q20, with aircraft reclassified as held-for-sale on the balance sheet
    - The company anticipates fourteen (14) Boeing 737 MAX will be delivered over the next 18 months, with negotiations ongoing
- Passenger traffic (RPMs) of 15 mm (-99.7% y/y) and capacity (ASMs) of 31 mm (-99.5%) led to a load factor of 48%
    - Connectivity operations, which management states will not be impacted by travel restrictions, are expected to restart by end-August '20
        - Full operations are expected to gradually restart with the lifting of travel restrictions on August 21st, pending further extension
    - Management guided towards reduction in demand of 90% y/y in the short-term, recovering to down 75% over a 5-6 month period
    - Pending further travel restrictions, capacity guidance is estimated to be < 10% of Sept. 2019, reaching 30-40% of 2019 ASMs by December '20
    - The company plans to fly ten (10) routes, include Brazil (São Paulo), Chile (Santiago), Cuba (Havana) and Costa Rica (San Jose), the Dominican Republic (Santo Domingo), Ecuador (Guayaquil, Quito) Mexico (Mexico City) and the United States (Miami, New York)
- Revenue of US$15 mm decreased 98% y/y and q/q, driven by a sharp reduction in bookings resulting from the COVID-19 pandemic and related travel restrictions
- Adjusted EBITDA turned negative, again driven by the sharp decline in revenues on reduced travel demand
    - Depreciation and Amortization decreased 4% y/y and increased 2% q/q to US$66 mm
        - We highlight our clean D&A excludes the non-recurring, non-cash (1) US$187 mm in fleet impairments and (2) US$50 mm in expected losses on Embraer assets held for sale. These are instead recognized as reversals in our Adjusted EBITDA calculation
    - Non-cash reversals include:
        - US$187 mm in non-cash non-recurring charges resulting from the planned sale of fourteen (14) Boeing 737-700
        - US$50 mm in expected losses related based on adjustments to the sales price of the fourteen (14) Embraer 190s, as noted above
        - US$12 mm in unredeemed ticket revenue provisions
- LTM Adjusted EBITDA of US$548 mm decreased 17% y/y and 28% q/q, at an LTM adj. EBITDA margin of 25% (+230 bps y/y, -126 bps q/q)
- Management reported cash burn of US$77 mm per month, better than management's prior estimates (US$85 mm/mo) on reduction of fixed expenses (converted to variable), lower cash ticket refunds than originally forecasted, and the suspension/deferral of all non-essential capex for the remainder of FY20, as disclosed in its prior 1Q20 earnings call
    - We highlight Copa's reported cash burn definition includes cash disbursements less proceeds (excl. extraordinary financing activities)

    - Management anticipates this will contract to US$66/mo in 2H20, with reductions related to the restart of operations (~US$4 mm) and other operating costs (US$6 mm), and including full payment of leased aircraft and debt commitments and interest payments
- Gross Debt increased 9% q/q to US$1,596 mm, with LTM gross leverage expanding q/q to 3.1x
    - The company repaid US$95 mm in short-term credit facilities in 2Q20, which was balanced by the issuance of US$343 mm in CPA '25 converts and addition of US$150 mm in new committed credit facilities (undrawn)
    - Copa raised an additional US$105 mm via a secured revolving credit facility (RCF) in July '20, bringing total undrawn facilities to US$225 mm
- Cash (cash and equivalents + ST investments) was 4% higher q/q at US$1,048 mm (52% LTM revenues)
- Liquidity (cash + A/R) increased 1% q/q to US$1,077 mm (54% LTM revenues)
    - We estimate pro-forma liquidity is ~US$1.3 bn (64% LTM revenues), which includes US$1.1 bn cash, US$225 mm in undrawn facilities. Taking a more conservative approach (v. prior estimates: ~US$1.8 bn), our updated pro-forma liquidity estimates exclude the following:
        - An additional US$50-100 mm financeable via unencumbered assets, which management stated they could incorporate into the existing US$105 mm secured RCF over the next several months
        - Additional liquidity via compensation for Boeing's grounding of the MAX, which could include over US$400 mm in pre-delivery deposits, based on recorded deposits at end-Dec. '19 (2019 20-F) and settlements from other carriers. We expect Copa will have a similar ability to negotiate delivery terms as well, a positive for the airline as they manage capacity with the return of demand
- LTM net debt was US$548 mm, with LTM net leverage of 1.1x (+0.4x q/q) driven by reduced profitability

| Copa Holdings S.A. (US$MM) | 2Q20 | 1Q20 | 4Q19 | 3Q19 | 2Q19 | y/y | q/q |
|---|---|---|---|---|---|---|---|
| **Load Factor** | **48.4%** | **81.5%** | **85.3%** | **85.6%** | **85.1%** | **(3,674 bps)** | **(3,307 bps)** |
| **Revenue** | **15** | **595** | **682** | **708** | **645** | **(98%)** | **(98%)** |
| **EBIT** | **(358)** | **99** | **18** | **133** | **83** | **(533%)** | **(463%)** |
| Depreciation & Amortization | 68 | 66 | 70 | 73 | 71 | (4%) | 2% |
| **EBITDA** | **(290)** | **165** | **88** | **206** | **153** | **(289%)** | **(276%)** |
| *EBITDA margin* | - | *27.7%* | *12.9%* | *29.1%* | *23.7%* | - | - |
| Add: Unredeemed ticket revenue provision reversal | 12 | - | - | - | - | - | - |
| Add: Fleet impairment | 187 | - | 89 | - | - | - | - |
| Add: Expected loss on Embraer assets held for sale | 50 | - | - | - | - | - | - |
| **Adjusted EBITDA** | **(40)** | **165** | **178** | **206** | **153** | **(126%)** | **(124%)** |
| *Adjusted EBITDA margin* | - | *27.7%* | *26.0%* | *29.1%* | *23.7%* | - | - |
| | | | | | | | |
| Cash and equivalents | 307 | 340 | 159 | 225 | 226 | 36% | (10%) |
| Short-term investments | 741 | 673 | 692 | 536 | 523 | 42% | 10% |
| **Cash** | **1,048** | **1,013** | **851** | **761** | **749** | **40%** | **4%** |
| Accounts receivable | 29 | 50 | 130 | 138 | 159 | (82%) | (42%) |
| **Liquidity** | **1,077** | **1,062** | **981** | **900** | **908** | **19%** | **1%** |
| | | | | | | | |
| **Gross Debt** | **1,596** | **1,467** | **1,365** | **1,432** | **1,595** | **0%** | **9%** |
| Loans and borrowings | 1,325 | 1,169 | 1,061 | 1,101 | 1,242 | 7% | 13% |
| Lease liabilities | 270 | 297 | 305 | 331 | 353 | (23%) | (9%) |
| **Net Debt** | **548** | **454** | **514** | **671** | **846** | **(35%)** | **21%** |
| **LTM Revenue** | **2,000** | **2,631** | **2,707** | **2,682** | **2,646** | **(24%)** | **(24%)** |
| **LTM Adj. EBITDA** | **508** | **702** | **718** | **669** | **612** | **(17%)** | **(28%)** |
| **LTM Adj. Gross Leverage** | **3.1x** | **2.1x** | **1.9x** | **2.1x** | **2.6x** | **0.5x** | **1.0x** |
| **LTM Adj. Net Leverage** | **1.1x** | **0.6x** | **0.7x** | **1.0x** | **1.4x** | **(0.3x)** | **0.4x** |
| | | | | | | | |
| **Cash / Revenue** | **52%** | **38%** | **31%** | **28%** | **28%** | **2,409 bps** | **1,391 bps** |
| **Liquidity / Revenue** | **54%** | **40%** | **36%** | **34%** | **34%** | **1,952 bps** | **1,346 bps** |

**Equity Upside/(Downside) Case:**

Cash burn/day assumes flat recovery, using mid-range cash burn estimates for both Copa (US$3 mm/ day) and AirCan (CAD 15-17mm/day), which we adjust based on average f/x rate for 3Q20 YTD. Pro-forma liquidity includes cash, short-term investments, accounts receivable and undrawn facilities, which we assume are drawn down. It excludes any potential government WK financing or management identified additional liquidity sources.

| Pro-Forma Balance Sheet (US$MM) | Air Canada | Copa |
|---|---|---|
| Company Reported Cash Burn / Day | (13) | (3) |
| Company Reported Cash Burn / Month | (379) | (66) |
| **Months of Liquidity Runway** | **18** | **20** |
| 2Q20 Cash and Equivalents | 6,367 | 1,048 |
| + Post-1Q20 Additional Financing (1) | 0 | 225 |
| **Current Est. Cash and Equivalents** | **6,367** | **1,273** |
| + 2Q20 Accounts Receivable | 499 | 29 |
| **Current Est. Liquidity** | **6,866** | **1,302** |
| - Reported Est. Monthly Cash Burn Run Rate 2H20 | (2,273) | (396) |
| **Pro-Forma 2020 Cash and Equivalents** | **4,094** | **877** |
| + 2Q20 Accounts Receivable (2) | 499 | 29 |
| **Pro-Forma 2020 Liquidity** | **4,593** | **906** |
| **BCP Est. Pro-Forma 2020 Debt** | **10,414** | **1,896** |
| **BCP Est. Pro-Forma 2020 Net Debt** | **6,320** | **1,019** |

*(1) Accounts for additional financing post-1Q20 (assumes draw-down of available credit facilities), as well as lease and interest deferrals. Excludes gov't WK Financing*

| Enterprise Value (US$MM) | Air Canada | Copa |
|---|---|---|
| **Current** | | |
| Market Cap (8/11/2020) | 3,729 | 2,116 |
| 2Q20 Net Debt + Other | 3,945 | 548 |
| **EV** | **7,673** | **2,664** |
| 2Q20 LTM EBITDA | 903 | 508 |
| **Current EV / EBITDA** | **8.5x** | **5.2x** |
| **2019 Year End Trailing** | | |
| Market Cap | 9,899 | 4,561 |
| Net Debt | 2,540 | 509 |
| **EV** | **12,439** | **5,069** |
| EBITDA | 2,760 | 718 |
| **2019 TEV / EBITDA** | **4.5x** | **7.1x** |
| **Pro-Forma for Full Recovery** | | |
| Market Cap (8/11/2020) | 3,729 | 2,116 |
| BCP Est. Pro-Forma Net Debt (1) | 6,320 | 1,019 |
| **TEV** | **10,049** | **3,135** |
| Full Recovery EBITDA (3) | 2,760 | 718 |
| **Full Recovery EV / EBITDA** | **3.6x** | **4.4x** |

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

*(2) In line with 2019 EBITDA*

- **Equity Upside Case**:
    - Scenario 1: Assuming a pathway to more stable profitability, with EV returning to 7.1x and adj. EBITDA to US$718 mm (in line with 2019) alongside flat pro-forma net debt y/y, implies US$4.1 bn in market cap, or 91% upside from current levels
    - Scenario 2: Even more conservative estimates of US$575 mm EBITDA (in line BBG Consensus ’22) at 7.1x EV imply US$3.0 bn in market cap, or 44% upside from current levels

| Equity Upside/(Downside) (US$MM) | Air Canada | Copa |
|---|---|---|
| **Current Market Cap** | **3,729** | **2,116** |
| **Current Enterprise Value (EV)** | **7,673** | **2,664** |
| **Current EV / EBITDA** | **8.5x** | **5.2x** |
| **Scenario 1:** | | |
| 2019 EV / EBITDA | 4.5x | 7.1x |
| Fully Recovered EBITDA (1) | 2,760 | 718 |
| EV | 12,439 | 5,069 |
| 2021 Pro-Forma Net Debt | 6,320 | 1,019 |
| Implied Market Cap | 6,119 | 4,050 |
| **Upside/(Downside) Potential** | **64%** | **91%** |
| **Scenario 2:** | | |
| 2019 EV / EBITDA | 4.5x | 7.1x |
| BBG Consensus EBITDA (2) | 1,980 | 575 |
| EV | 8,924 | 4,062 |
| 2020 Pro-Forma Net Debt | 6,320 | 1,019 |
| Implied Market Cap | 2,604 | 3,043 |
| **Upside/(Downside) Potential** | **(30%)** | **44%** |

*(1) In line with 2019 EBITDA*
*(2) BBG consensus 2022 EBITDA*
** Prices sourced from BBG as of close 8/11/2020*


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