

BCP Research: Air Canada (ACACN) – 3Q20 Results, Weak – Maintain ‘Neutral’

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Summary: Canada’s largest passenger airline, Air Canada (AirCan) released 3Q20 results in line with expectations, with load factors remaining depressed at 42% as capacity increases outweighed recovery in demand. As a result, revenue showed marginal recovery and adj. EBITDA remained negative at -US\$416 mm. Cash burn was better than expected, reducing to US\$420 mm v. US\$1,072 mm in 2Q20. Cash decreased slightly to US\$5,838 mm, but remained robust at 84% cash to LTM revenue. The company ended the quarter with net debt of US\$4,401 mm. AirCan’s US\$6,226 mm in liquidity remains among the highest within our coverage, implying 31 months of liquidity runway based on run-rate reported cash burn (US\$7 mm/day).

We continue to see a slow pathway to recovery for AirCan, exacerbated by both fleet and route mix. 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 estimate 3.5x TEV to fully recovered EBITDA (59% upside on the common), assuming recovery to FY19 EBITDA levels and flat net debt. Assuming implied upside on the common and tightening of the spread to UST, we estimate 188c FV v. 70c BF (36% upside v. 49% downside) on ACACN 25s from the current price of 138c. We remain neutral on the ACACN 25s, with limited spread between the IVOL on the converts (49%) v. 100D volatility (66%) and listed volatility (60%) on the common, and bonds appearing fairly valued, given outsized downside and the risks involved.

	Amt (US\$ MM)	Ratings (M/SP/F)	Mid Price	Mid YTM	Rank
ACACN 7.75% 4/15/2021	400	Ba3/ B/ B+	101.2	4.59%	Sr. Unsecured

	Coupon	Maturity	Amt Out (US\$ MM)	Mid Price	Mid YTM	IVOL	Cheapness (par)	Delta (par)	Conv. Price	AC CN Price	Rank
ACACN	4.0%	7/1/2025	748	137.9	(3.51%)	48.75%	0.48%	84.47%	\$15.25	\$16.08	Sr. Unsecured

* Prices sourced from BBG as of November 20, 2020

3Q20 Operating Results:

- **RPMs:** Revenue passenger miles (RPMs) were down 91% y/y but increased 221% q/q to 2,517 mm
- **ASMs:** Average seat miles (ASMs) were reduced 82% y/y but increased 165% q/q to 5,949 mm
 - Capacity (ASMs) is expected to improve to ~75% down from 4Q19 capacity in 4Q20
- **Passenger load factor** expanded to 42.3%, but remained significantly depressed, reflecting ongoing capacity issues
- **Yield** increased 9% y/y but decreased 20% q/q to USD 15.2 cents, reflecting changes in traffic mix
- **PRASM** decreased 47% y/y and 4% q/q to USD 6.4 cents, in line with reduced passenger load factor, which was partially offset by increased yield improvements
- **CASM** increased 81% y/y but decreased 71% q/q to USD 19.4 cents
- **Adj. CASM**, was USD 19.6 cents (+159% y/y, -65% q/q) and excludes fuel expenses, cost of ground packages at Air Canada and special items
- **Routes** to thirty (30) domestic regional locations have been suspended indefinitely and eight (8) stations at regional Canadian airports have been closed
- **Fleet** totaled 217 at end-3Q20 (v. 211 at end-2Q20), made up of 77 wide-body and 102 narrow-body at AirCan, and 38 narrow-body at Air Canada Rouge

- Additional fleet: AirCan has 134 additional Embraer and Bombardier aircraft (v. 137 at end-2Q20), 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
- AirCan is permanently retiring seventy-nine (79) older aircraft from its fleet, including its Boeing 767s, Airbus 319s and Embraer 190 aircraft
 - Fifty (50) of these aircraft were retired in 2Q20, including fourteen (14) Embraer 190s, thirty (30) Boeing 767s and six (6) Airbus A319
- Purchase agreements for the remaining Airbus A220-300 aircraft have been amended, with AirCan deferring eighteen (18) deliveries over '21-'22 and cancelling the purchase of the remaining twelve (12) A220s
 - The company now expects the delivery of a total of thirty three (33) Airbus A220s
 - The company expects to take delivery of five (5) of the Airbus A220 aircraft in 4Q20
- Purchase agreements with Boeing have also been amended, and include the cancellation of an additional ten (10) Boeing 737 MAX-8 aircraft from its order of fifty (50) aircraft, and deferring sixteen (16) of its remaining aircraft deliveries to late '21-'23
 - AirCan currently has 24 Boeing 737 MAX in its fleet, which have been grounded since March '19
 - The company has entered into a sale and leaseback of nine Boeing 737 MAX-8, for which it expects a total of US\$365 mm in proceeds to come in post-3Q20, resulting in an increase of AirCan's unencumbered asset pool to ~US\$1.3 bn (CAD 1.8 bn)
 - AirCan now expects the delivery of forty (40) Boeing 737 MAX aircraft v. its original order of sixty-one (61) aircraft

Air Canada (USD MM)	3Q20	2Q20	1Q20	4Q19	3Q19	y/y	q/q
RPM (mm)	2,517	783	17,507	21,403	27,954	(91%)	221%
ASM (mm)	5,949	2,243	23,511	26,431	32,457	(82%)	165%
Passenger Load Factor (%)	42.3%	34.9%	74.5%	81.0%	86.1%	(4,382 bps)	740 bps
Yield (cents)	15.2	19.1	12.9	14.3	14.0	9%	(20%)
PRASM (cents)	6.4	6.6	9.7	11.5	12.0	(47%)	(4%)
CASM (cents)	19.4	67.0	12.6	12.5	10.7	81%	(71%)
Adj. CASM (cents)	19.6	55.5	9.3	9.0	7.6	159%	(65%)

3Q20 Financial Results:

- **Revenue** decreased 86% y/y but increased 49% q/q to US\$568 mm, again in line with government regulated travel restrictions the anticipated low point of the COVID-19 pandemic
- **Adj. EBITDA turned** remained negative (-US\$416 mm), though improved q/q as revenues increased on improved traffic
- **Cash burn** of US\$420 mm, while improved q/q, also remained negative, driven primarily by profit loss and higher capex, which outweighed working capital inflow
 - Cash lease payments decreased 4% q/q to US\$37 mm
 - We note cash lease payments now exclude principal repayments
 - Interest payments were 6% lower q/q at US\$91 mm
 - The company recorded a tax refund of US\$66 mm in the quarter

- Capex increased 38% q/q to US\$212 mm
- Working capital inflow was US\$269 mm v. outflow of US\$183 mm in the prior quarter
 - Inflow in the quarter was mainly attributable a decrease in trade accounts receivable (US\$119 mm), an increase in accounts payable and accrued expenses (US\$224 mm) and a decrease in advanced ticket sales (-US\$83 mm)

Air Canada (USD MM)	3Q20	2Q20	1Q20	4Q19	3Q19	y/y	q/q
Revenue	568	380	2,647	3,377	4,194	(86%)	49%
Operating Income	(589)	(1,122)	(308)	112	722	(182%)	(47%)
Depreciation & amortization	318	351	358	400	390	(19%)	(10%)
EBITDA	(272)	(771)	50	512	1,112	-	(65%)
<i>EBITDA margin</i>	<i>(48%)</i>	<i>(203%)</i>	<i>2%</i>	<i>15%</i>	<i>27%</i>	-	<i>15,484 bps</i>
Impairments	(2)	238	-	-	-	-	-
Workforce reduction provision	-	81	-	-	-	-	-
Canada emergency wage subsidy	(142)	(146)	-	-	-	-	(3%)
Other	-	(3)	-	-	-	-	-
Adj. EBITDA	(416)	(600)	50	512	1,112	-	(31%)
<i>Adj. EBITDA margin</i>	<i>(73%)</i>	<i>(158%)</i>	<i>2%</i>	<i>15%</i>	<i>27%</i>	-	<i>8,469 bps</i>
Cash lease	(37)	(38)	(39)	(42)	(43)	(15%)	(4%)
Interest paid	(91)	(97)	(78)	(95)	(87)	5%	(6%)
Taxes paid	66	-	(65)	(12)	(13)	-	-
Capex	(212)	(153)	(265)	(193)	(227)	(7%)	38%
Working capital	269	(183)	(532)	(65)	(334)	-	-
Free Cash Flow	(420)	(1,072)	(929)	104	408	-	(61%)

- **Cash** decreased 8% q/q to US\$5,838 mm (84% LTM revenue), reflecting cash burn and repayment of principal on LT debt and lease liabilities (US\$1.0 bn – net of cash lease payments), balanced by the inflow of proceeds from borrowings in the quarter (US\$836 mm)
- **Liquidity** decreased 9% q/q to US\$6,226 mm (89% LTM revenue)
 - 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\$6,148 mm, including cash, ST investments and LT investments (2Q20: US\$6,718 mm)
 - The company has also identified financeable unencumbered assets (excl. Aeroplan and AirCan Vacations) which, following the sale and leaseback of several Boeing 737 MAX post-3Q20, is valued at ~US\$1,351 mm (CAD 1.8 bn)
- **Gross Debt** decreased 1% q/q to US\$10,239 mm, in line with net reduction of LT debt and lease liabilities in the quarter
 - Fixed rate USD financing increased 20% q/q to US\$3.0 bn, balanced by a 61% q/q decrease in floating rate USD financing to US\$388 mm, and 5% decrease q/q in lease liabilities to US\$2.5 bn
 - The company concluded a private offering of two tranches of EETCs for an aggregate US\$553 mm at a weighted average interest rate of 5.73%. Notes are secured by three (3) Boeing 787-9s, three (3) Boeing 777-300ERs, one (1) Boeing 777-200LR and nine (9) Airbus A321-200 aircraft. Proceeds were used along with cash on hand to repurchase the US\$600 mm 364-day term loan
 - In addition, the company concluded a committed secured facility, totaling US\$592 mm (CAD 788 mm), to replace bridge financing procured in April '20 for the purchase of 18 Airbus A220 aircraft, which serve as collateral for the new facility

- **Net debt** increased 12% q/q to US\$4,401 mm following cash burn in the quarter

Air Canada (USD MM)	3Q20	2Q20	1Q20	4Q19	3Q19	y/y	q/q
Cash and Equivalents	2,846	3,749	1,926	2,878	2,948	(3%)	(24%)
ST Investments	2,992	2,619	2,634	2,878	2,948	1%	14%
Cash	5,838	6,367	4,560	5,757	5,897	(1%)	(8%)
Accounts Receivable	389	499	422	702	678	(43%)	(22%)
Liquidity	6,226	6,866	4,982	6,458	6,575	(5%)	(9%)
Aircraft financing	4,473	4,568	3,266	3,346	3,477	29%	(2%)
Convertible notes	748	748	-	-	-	-	-
Senior secured notes	781	766	149	152	151	416%	2%
Senior unsecured notes	400	400	418	394	401	(0%)	0%
Other USD secured financing	1,167	1,168	1,223	558	575	103%	(0%)
Other CAD secured financing	149	147	148	-	-	-	2%
Lease liabilities	2,521	2,647	2,818	2,621	2,555	(1%)	(5%)
Unamortized debt issuance costs	-	(131)	(65)	(68)	(71)	-	-
Gross Debt	10,239	10,312	7,958	7,002	7,089	44%	(1%)
Net Debt	4,401	3,945	3,397	1,246	1,192	269%	12%
LTM Revenue	6,973	10,598	13,851	14,525	14,262	(51%)	(34%)
LTM EBITDA	(480)	903	2,374	2,760	2,702	(118%)	(153%)
LTM Gross Leverage	NM	11.4x	3.4x	2.5x	2.6x	-	-
LTM Net Leverage	NM	4.4x	1.4x	0.5x	0.4x	-	-
Cash to LTM Revenue	84%	60%	33%	40%	41%	4,237 bps	2,364 bps
Liquidity to LTM Revenue	89%	65%	36%	44%	46%	4,320 bps	2,452 bps

Equity Upside/(Downside) Case:

Cash burn/day is based on reported 3Q20 cash burn for AirCan (US\$6.8 mm/day) and reported cash burn estimates for Copa (US\$0.8 mm/ day). 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.

Assuming a pathway to more stable profitability, with AirCan's EV and adj. EBITDA returning to 2019 levels, and net debt flat, implies US\$7.6 bn in market cap, or 59% upside on the equity from current levels. Tightening the spread to UST two years out, we estimate 188c FV v. 70c BF on ACACN 25s or 36% upside v. 49% downside from the current price of 138c. With outsized downside potential, and limited spread between IVOL on the converts (49%) v. 100D volatility (66%) and listed volatility (60%), we remain neutral on the ACACN '25s.

Pro-Forma Balance Sheet (US\$MM)	Air Canada (1)	Copa
Company Reported Cash Burn / Day	(6.8)	(0.8)
3Q20 Months of Liquidity Runway	31	36
3Q20 Liquidity	6,350	904
(-) 3Q20 Accounts Receivable	397	37
3Q20 Cash and Equivalents	5,838	866
(-) Reported Cash Burn	(612)	(75)
(+) Pro-Forma Additional Financing (2)	365	305
Pro-Forma Cash and Equivalents	5,591	1,096
(+) Pro-Forma Accounts Receivable	397	37
Pro-Forma Liquidity	5,987	1,134
Pro-Forma Months of Liquidity Runway	29	45
BCP Est. Pro-Forma 2020 Debt (2)	10,442	1,795
BCP Est. Pro-Forma 2020 Net Debt (2)	4,851	699
BCP Est. Fully Recovered EBITDA (2)	2,760	718
BCP Est. Pro-Forma Net Leverage (2)	1.8x	1.0x

(1) Air Canada and adjusted for f/x changes, based on f/x end November 20, 2020

(2) Accounts for estimated additional financing, sale and leaseback and Boeing compensation post-3Q20, as well as lease and interest deferrals. Excludes gov't WK Financing

Enterprise Value (US\$MM)	Air Canada	Copa
Current		
Market Cap (11/20/2020)	4,771	3,227
2Q20 Net Debt + Other	4,401	624
		3,85
EV	9,172	1
2Q20 LTM EBITDA	903	258
Current EV / EBITDA	10.2x	14.9x
2019 Year End Trailing		
Market Cap	9,899	4,561
Net Debt	2,540	509
		5,06
EV	12,439	9
EBITDA	2,760	718
2019 TEV / EBITDA	4.5x	7.1x
Pro-Forma for Full Recovery		
Market Cap (11/20/2020)	4,771	3,227
BCP Est. Pro-Forma Net Debt (1)	4,851	699
		3,92
TEV	9,623	6
Full Recovery EBITDA (1)	2,760	718
Full Recovery EV / EBITDA	3.5x	5.5x

(1) In line with 2019 EBITDA

Equity Upside/(Downside) (US\$MM)	Air Canada	Copa
Current Market Cap	4,771	3,227
Current Enterprise Value (EV)	9,172	3,851
Current EV / EBITDA	10.2x	14.9x
2019 EV / EBITDA	4.5x	7.1x
Fully Recovered EBITDA (1)	2,760	718
EV	12,439	5,069
Pro-Forma Net Debt	4,851	699
Implied Market Cap	7,588	4,370
Upside/(Downside) Potential	59%	35%

(1) In line with 2019 EBITDA

* Prices sourced from BBG as of close November 20, 2020

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"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.

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

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

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