

BCP Research: Copa Holdings S.A (CPA) – 3Q20 Results, Mixed- Downgrade to ‘Neutral’

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Summary: International Panama-based airline, Copa released mixed 3Q20 results. Revenues recovered q/q, with the easing of travel restrictions, while EBITDA remained negative, with costs outpacing recovery in demand. Reported cash burn was US\$36 mm/month, significantly lower than the prior quarter, at US\$77mm/month. Copa paid down US\$50 mm in short-term lines of credit and obtained US\$155 mm in new lines of credit. Cash decreased to US\$866 bn (65% LTM revenues), while availability of undrawn lines of credit increased to US\$305 mm. The company ended the quarter with US\$624 mm in net debt, and LTM net leverage of 2.4x.

Copa has restarted operations through its Panama hub, serving 38 destinations as of November 15, 2020, expected to reach 50 destinations by YE20. Cash consumption per month is expected to reduce to US\$25 mm for the remainder of FY20, while total liquidity of US\$1.2 bn leaves the airline well positioned to weather the storm. Nevertheless, the risk continues to be Copa’s unique international hub model, which may require a longer runway to recovery, while facing ample and competitive point-to-point capacity, with Copa’s capacity estimated to reach only 40% of Dec. ‘19 levels at year end.

Were Copa to recover to 2019 US\$718 mm adj. EBITDA levels at the same 7.1x EV/adj. EBITDA, we estimate 35% upside on the common. Assuming the spread tightens, two years out, we estimate 208c FV v. 70c BF on CPA 25s or 26% upside v. 58% downside from the current price of 166c, not supporting an outright bullish call. At the same time, the spread between IVOL on the converts (41%) v. 100D volatility (69%) and listed volatility (57%) has tightened. Accordingly, we downgrade our “Positive – Swap” rating on CPA ‘25s to “Neutral.”

| | | | 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 | 165.9 | (7.79%) | 41.14% | 2.62% | 89.49% | \$51.66 | \$76.33 |

* Prices sourced from BBG as of November 20, 2020

3Q20 Operating and Financial Results:

- At end-3Q20 the company had a consolidated fleet of seventy-four (74) aircraft comprised of six (6) Boeing 737 MAX9s, sixty-eight (68) Boeing 737-800s
- Passenger traffic (RPMs) was 57 mm (-99% y/y, +280% q/q) and capacity (ASMs) was 95 mm (-99% y/y, +206% q/q), resulting in a load factor of 60% (-2,599 bps y/y, +1,161 bps q/q)
 - The company ended the quarter with service to 15 destinations
 - We note capacity in 3Q20 was 1.5% of 3Q19 capacity, and September ‘20 capacity was 3% of September ‘19 capacity

| Copa Holdings S.A. (US\$MM) | 3Q20 | 2Q20 | 1Q20 | 4Q19 | 3Q19 | y/y | q/q |
|-----------------------------|-------|-------|-------|-------|-------|-------------|-------------|
| RPMs (mm) | 57 | 15 | 4,473 | 5,244 | 5,466 | (99%) | 280% |
| ASMs (mm) | 95 | 31 | 5,491 | 6,149 | 6,386 | (99%) | 206% |
| Load Factor | 60.0% | 48.4% | 81.5% | 85.3% | 85.6% | (3,674 bps) | (3,307 bps) |

- Revenue was down 95% y/y but increased 123% q/q, driven by unredeemed ticket revenue and increased passenger revenue, reflecting recovery in traffic on easing of travel restrictions
- Adjusted EBITDA remained negative at -US\$44 mm
- Management reported cash burn (excl. extraordinary expense) was -US\$109 mm, significantly improved from prior quarters reported cash burn of -US\$232 mm
 - Cash burn/day was US\$1.2 mm in 3Q20 v. US\$2.6 mm in 2Q20

- Improvements in cash burn were mainly driven by cost reductions, renegotiation of contracts (power-by-the-hour), reduced cash refunds, and better than expected incoming sales
- Cash (cash and equivalents + ST investments) decreased 17% q/q to US\$866 mm (65% of LTM revenues)
- Liquidity (cash + A/R) decreased 16% q/q to US\$902 mm (68% of LTM revenues)
 - Liquidity, including undrawn facilities, increased to US\$1.3 bn, following the obtainment of US\$155 mm in new credit facilities
 - We note US\$305 mm in credit facilities remain entirely undrawn
- Gross Debt decreased 7% q/q to US\$1,490 mm, following the repayment of US\$50 mm in ST lines of credit
- Net debt increased 21% q/q US\$624 mm and LTM net leverage expanded to 2.4x, both driven by cash burn in the quarter

| Copa Holdings S.A. (US\$MM) | 3Q20 | 2Q20 | 1Q20 | 4Q19 | 3Q19 | y/y | q/q |
|---|--------------|--------------|--------------|--------------|--------------|------------------|------------------|
| Revenue | 32 | 15 | 595 | 682 | 708 | (95%) | 123% |
| EBIT | (107) | (358) | 99 | 18 | 133 | - | (70%) |
| Depreciation & Amortization | 63 | 68 | 66 | 70 | 73 | (14%) | (7%) |
| EBITDA | (44) | (290) | 165 | 88 | 206 | - | (85%) |
| <i>EBITDA margin</i> | - | - | 27.7% | 12.9% | 29.1% | - | - |
| Unredeemed ticket revenue provision | - | 12 | - | - | - | - | - |
| Fleet impairment | - | 187 | - | 89 | - | - | - |
| Expected loss on Embraer assets held for sale | - | 50 | - | - | - | - | - |
| Adjusted EBITDA | (44) | (40) | 165 | 178 | 206 | - | 9% |
| <i>Adjusted EBITDA margin</i> | - | - | 27.7% | 26.0% | 29.1% | - | - |
| Cash and equivalents | 222 | 307 | 340 | 159 | 225 | (1%) | (28%) |
| Short-term investments | 644 | 741 | 673 | 692 | 536 | 20% | (13%) |
| Cash | 866 | 1,048 | 1,013 | 851 | 761 | 14% | (17%) |
| Accounts receivable | 36 | 29 | 50 | 130 | 138 | (74%) | 24% |
| Liquidity | 902 | 1,077 | 1,062 | 981 | 900 | 0% | (16%) |
| Loans and borrowings | 1,249 | 1,325 | 1,169 | 1,061 | 1,101 | 13% | (6%) |
| Lease liabilities | 242 | 270 | 297 | 305 | 331 | (27%) | (11%) |
| Gross Debt | 1,490 | 1,596 | 1,467 | 1,365 | 1,432 | 4% | (7%) |
| Net Debt | 624 | 548 | 454 | 514 | 671 | (7%) | 14% |
| LTM Revenue | 1,324 | 2,000 | 2,631 | 2,707 | 2,682 | (51%) | (34%) |
| LTM Adj. EBITDA | 258 | 508 | 702 | 718 | 669 | (61%) | (49%) |
| <i>LTM Adjusted EBITDA margin</i> | 19.5% | 25.4% | 26.7% | 26.5% | 24.9% | (543 bps) | (590 bps) |
| LTM Adj. Gross Leverage | 5.8x | 3.1x | 2.1x | 1.9x | 2.1x | 3.6x | 2.6x |
| LTM Adj. Net Leverage | 2.4x | 1.1x | 0.6x | 0.7x | 1.0x | 1.4x | 1.3x |
| Cash / Revenue | 65% | 52% | 38% | 31% | 28% | 3,703 bps | 1,302 bps |
| Liquidity / Revenue | 68% | 54% | 40% | 36% | 34% | 3,457 bps | 1,427 bps |

Liquidity Breakdown:

For clarification, we compare our cash and liquidity calculation vs. Copa's

| Copa Available Liquidity (US\$MM) | 3Q20 | 2Q20 | 1Q20 | 4Q19 | 3Q19 | y/y | q/q |
|-----------------------------------|--------------|--------------|--------------|------------|------------|-------------|--------------|
| BCP Calculated Liquidity: | | | | | | | |
| Cash and equivalents | 222 | 307 | 340 | 159 | 225 | (1%) | (28%) |
| Short-term investments | 644 | 741 | 673 | 692 | 536 | 20% | (13%) |
| Cash | 866 | 1,048 | 1,013 | 851 | 761 | 14% | (17%) |
| Accounts receivable | 36 | 29 | 50 | 130 | 138 | (74%) | 24% |
| Liquidity | 902 | 1,077 | 1,062 | 981 | 900 | 0% | (16%) |
| Copa Reported Liquidity: | | | | | | | |
| Cash and equivalents | 222 | 307 | 340 | 159 | 225 | (1%) | (28%) |
| Cash | 222 | 307 | 340 | 159 | 225 | (1%) | (28%) |
| Short-term investments | 644 | 741 | 673 | 692 | 536 | 20% | (13%) |
| Long-term investments | 140 | 95 | 114 | 134 | 124 | 12% | 48% |
| Committed and undrawn facilities | 305 | 150 | n/a | n/a | n/a | - | 103% |
| Liquidity | 1,311 | 1,293 | 1,127 | 985 | 886 | 48% | 1% |

Company Guidance:

- Travel restrictions were lifted on the number of flights and entry for non-citizens and non-residents on October 11, 2020
 - As of November 15, 2020, the company has restarted service to 38 destination, expected to increase to 50 destinations at end-FY19 v. 80 pre-covid
 - Capacity (ASM) was 16% of October '19s, and is expected to increase to 30% of November '19 and 40% of Dec. 2019 capacity, the upper end of prior guidance
 - Load factor was 70% for the month of October '20
- Copa expects to have ~85 aircraft by end-FY21, with a portion of the aircraft held in storage
- Post-3Q20 the company has delivered three (3) of fourteen (14) Embraer 190s, which were sold to a third party, and signed a Letter of Intent for the sale of two (2) Boeing 737-700 aircraft, which are expected to be finalized and delivered in January '21
- The grounding order for Boeing 737 MAX aircraft was lifted on November 18, 2020
 - Two (2) of Copa's Boeing 737 MAX9s are expected to return to service by end-FY20
 - The company anticipates fourteen (14) Boeing 737 MAX will be delivered over the next 18 months, with negotiations ongoing
 - Two (2) Boeing 737 MAX9 aircraft are expected to be delivered in December '20, bringing total Boeing 737 MAX fleet to eight (8) aircraft
- Cash consumption per month (incl. lease and debt repayment in full, and excl. proceeds from aircraft sales) is expected to reduce to US\$25 mm for the remainder of FY20

Equity Upside/(Downside) Case:

Cash burn/day is based on reported cash burn estimates for Copa (US\$0.8 mm/ day) and reported 3Q20 cash burn for AirCan (US\$6.8 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 and flat pro-forma net debt y/y, with Copa's EV and adj. EBITDA returning to 2019 levels, implies a US\$4.4 bn in market cap, or 35% upside on the common from current levels. Assuming the spread tightens, two years out, we estimate 208c FV v. 70c BF on CPA 25s or 26% upside v. 58% downside from the current price of 166c. The outsized downside potential keeps us from taking an outright position. Meanwhile, the spread between IVOL on the converts (41%) v. 100D volatility (69%) and listed volatility (57%) has tightened. Appropriately, with the position relatively played out, we downgrade CPA '25s to 'Neutral'.

| 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 as of 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) | 4,872 | 3,227 |
| 2Q20 Net Debt + Other | 4,401 | 624 |
| | | 3,85 |
| EV | 9,273 | 1 |
| 2Q20 LTM EBITDA | 903 | 258 |
| Current EV / EBITDA | 10.3x | 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) | 4,872 | 3,227 |
| BCP Est. Pro-Forma Net Debt (1) | 4,851 | 699 |
| | | 3,92 |
| TEV | 9,723 | 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 | 4,872 | 3,227 |
| Current Enterprise Value (EV) | 9,273 | 3,851 |
| Current EV / EBITDA | 10.3x | 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 | 56% | 35% |

(1) In line with 2019 EBITDA

* Prices sourced from BBG as of November 20, 2020

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“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.

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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.

“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

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

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