Queen's Private Capital Group

LBO Pitch: Cargojet Inc. (TSX:CJT)

November 14, 2023

Agenda

Company Overview

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Cargojet Inc. (TSX:CJT)

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Cargojet Inc. provides time sensitive overnight air cargo services and carries approximately ~8 million pounds of cargo weekly.

Overview

- Founded in 2002 and headquartered in Mississauga, Cargojet is a provider of time sensitive overnight air cargo services
- The company operates scheduled overnight air cargo services for various customers, including major airlines, international freight forwarders, and government agencies
- Cargojet has an extensive domestic network, connecting key cities across Canada
- Cargojet's services cater to the transportation needs of a diverse range of industries including automotive, pharmaceuticals, and e-commerce
- The company has long-term customer contracts with minimum revenue guarantees and cost pass-through provisions

Management Team



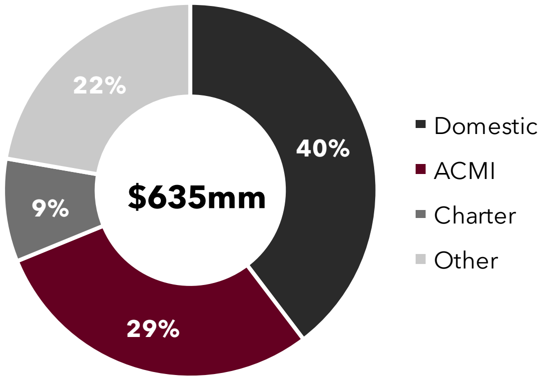

Name	Dr. Ajay Virmani	Jamie Porteous	Scott Calver	Pauline Dhillon
Position	President & CEO	CSO	CFO	CCO
Years Experience	21+	20+	17+	22+
Experience	Acquired 3000 Canada Cargo and formed Cargojet	Director of operations at Air Canada	CFO of Trimac Transportation	Part of the Cargojet team since inception

Segmented Revenue

Domestic Network (includes surcharges, interline and Newark/Bermuda route)

ACMI – Aircraft, Crew, Maintenance and Insurance

All-in Charter is primarily ad hoc business



Key Customers

- Overnight network reaching 90% of the Canadian population 24/7
- ~ 75% of domestic revenues are under long-term (3+ years) contracts with renewal options

AltiMax Courier	amazon	Andlauer Healthcare Group	BRINKS	Canada Post / Postes Canada
ceva logistics	Day & Ross	DHL	FedEx	ICS Courier
MIDLAND	Purolator	TFI International	TransForce	ups

Industry Overview

Air cargo is to continue growing

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Established air cargo players will command greater revenues in the near future due to increased demand for quick, reliable air cargo, and decreased growth of supply to meet demand

Overall demand growth & increased focus on cargo-only

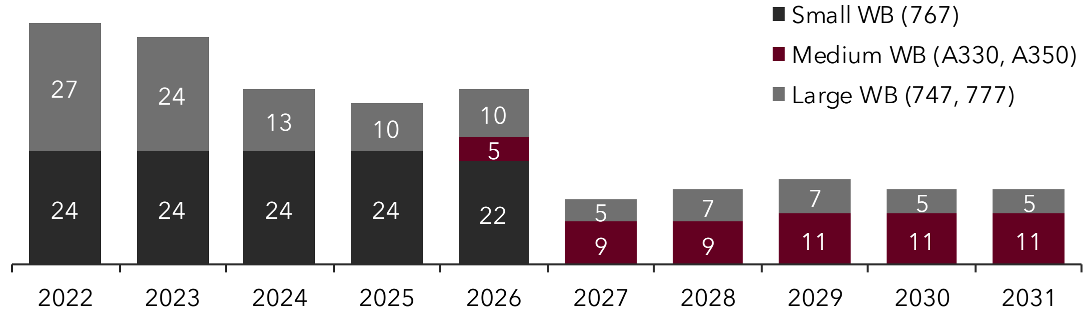
- Shifting focus to cargo-only players and ongoing supply gaps will allow existing leaders to increase pricing to meet demand
- COVID restrictions resulted in lower passenger underbelly capacity, shifting demand fulfillment to dedicated cargo players
  - Previous 50-50 split has not re-balanced, cargo takes 70%
- Environmental regulations restricting the production of small-body airplanes will constrain suppliers' ability to grow or meet demand
  - Conversions present a viable option to backfill supply gap

Competitive landscape

Combo Carrier	Cargo Only	Express Carrier	Passenger Only
Turkish Airlines, Lufthansa, Cathay	cargolux, AirACT	UPS, FedEx, DHL	American Airlines, United
41%	11%	38%	10%

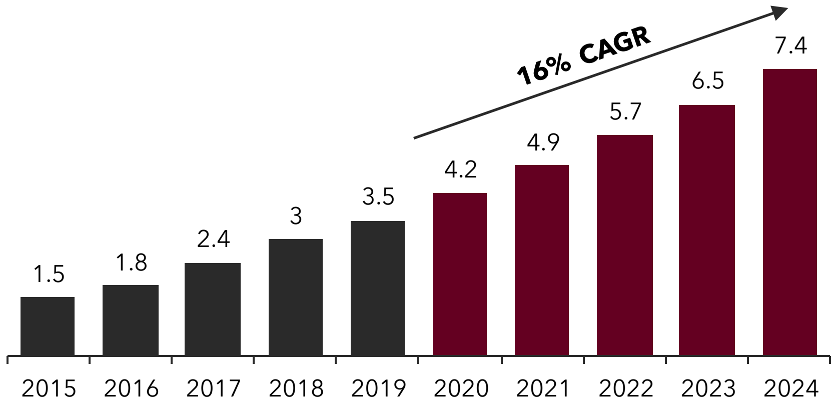
% of air cargo industry revenues

New freighter production outpaced by demand growth



New freighters built per year is declining as regulations restricting production of Small Widebody aircraft means that **new demand will not be met with supply**

E-commerce growth remains a strong tailwind for cargo rev.



80% of intl. e-commerce is shipped via air cargo

15% of all cargo is e-commerce

Source(s): CargoJet company filings, Boeing World Air Cargo Forecast, IATA E-Commerce Monitor (Q1 2022)

Investment Thesis

Advantages of Long-Term Contracts

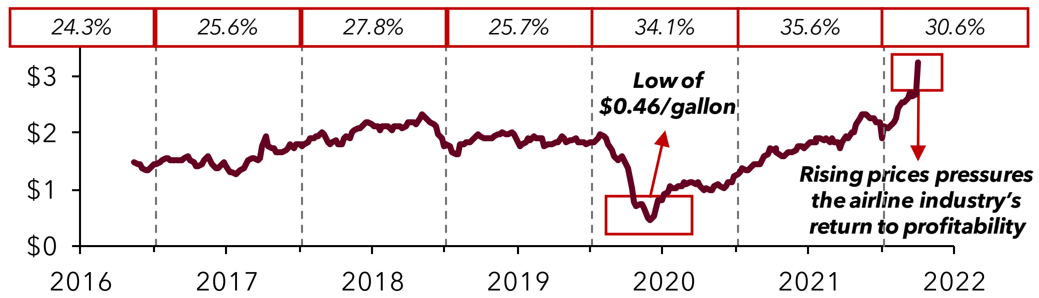
Long-term customer contracts accounted for 75% of 2022 revenues; CJT represents ~90% of the domestic overnight air cargo market in Canada, translating into high barriers to entry, significant pricing power, and a superior ability to pass-through uncontrollable variable costs

CJT's Ability to Pass-Through Costs

1. Long-term contracts provide **transparency into cash flows** and **minimum revenue guarantees**
2. CJT has a clause where shifts to uncontrollable variable costs tied to **fuel surcharges are passed-through** to the customer
3. CJT demonstrates an attractive ability to **maintain margins despite cost volatility** during the contract period

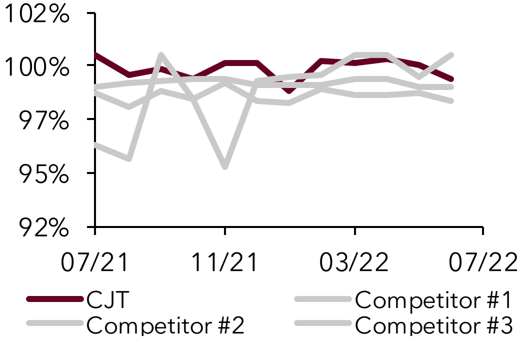
Historic Aviation Jet Fuel Prices[1] vs CJT EBITDA %

(in US$ per gallon)

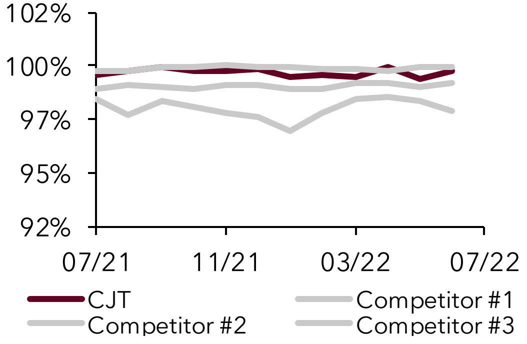


Industry Leading Dispatch Reliability Rates

B757



B767



CJT's fleet average dispatch reliability is 99.28%, ahead of its competitors

	B757		B767	
	Mean	*S.D.*	*Mean*	*S.D.*
CJT	**99.38%**	**0.49%**	**99.18%**	**0.20%**
Competitor #1	98.29%	1.95%	97.49%	0.45%
Competitor #2	98.70%	0.15%	99.39%	0.09%
Competitor #3	98.11%	0.31%	98.55%	0.13%

Sources: CJT 2022 Investor Presentation, Company Filings, Statista[1], S&P Capital IQ, Tegus

Creative Deployment of Growth CapEx Drive Capacity

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Through sale leasebacks and cargo conversions, mgmt. cites that CJT can purchase aircrafts "for at least 30-40% better than the market price"; amidst an expensive borrowing environment, creative capex deployment is especially important for growth in a capex heavy, capacity-constrained industry

Competitive Landscape

Full Service Carriers

QATAR AIRWAYS, UNITED AIRLINES, Emirates

Pure-play Cargo

magma aviation, silkway west airlines, DHL

Pre-COVID, ~50% of global air cargo was transported via passenger aircraft bellies. During the pandemic, passenger aircrafts were grounded, and 90% of air cargo moved to dedicated freighters. **The shift back to the 50%/50% model is recovering very slowly, and much of the lost belly capacity may not return**, especially as FSC are favoring adding back narrow-body capacity over wide-body capacity.

Example: The B777-200 Conversion Process

1. Aviation startup Mammoth Freighter takes its first customer order: convert two Boeing 777-200 passenger aircrafts to an all-cargo configuration for CJT
2. Mammoth needs to first get approval from the FAA for the modification in design; after the prototype, subsequent conversion processes will be shorter
3. Assembly work takes ~5 months, including gutting the interior, cutting the fuselage, adding a large door for pallets, and reinforcing the floor
4. These new conversions will be used for the DHL contract

Fleet Inventory & Volume Capabilities

Sale Leasebacks and Cargo Conversions Reduce Growth CapEx Needs

Cargojet purchases used passenger aircraft ("feedstock") and then converts the feedstock into cargo freights; growth capex for fleet expansion is supported by contracts (e.g. DHL has agreed to take on 9 additional freights as a part of its 7-year $2.3B contract)

	'19A	'20A	'21A	'22A	'23E	'24E	'25E
B757-200[1]	8	8	9	13	17	17	17
B767-300[1]	12	14	16	18	21	21	21
B767-200[1]	1	3	3	3	3	4	4
B777-200[1]	-	-	-	-	-	3	4
New Freighters	1	4	3	6	7	4	2
New Passenger Planes	-	-	-	2	0	0	0
New Planes	**1**	**4**	**3**	**8**	**7**	**4**	**2**
Growth CapEx[2] *(in $M)*	n/a	$84	$165	$486	$253	$287	$169
GC/New Plane	**n/a**	**$21**	**$55**	**$61**	**$36**	**$72**	**$85**
Freighter Fleet	21	25	28	34	41	45	47
Passenger Fleet	3	3	3	5	5	5	5
Total Fleet	**24**	**28**	**31**	**39**	**46**	**50**	**52**

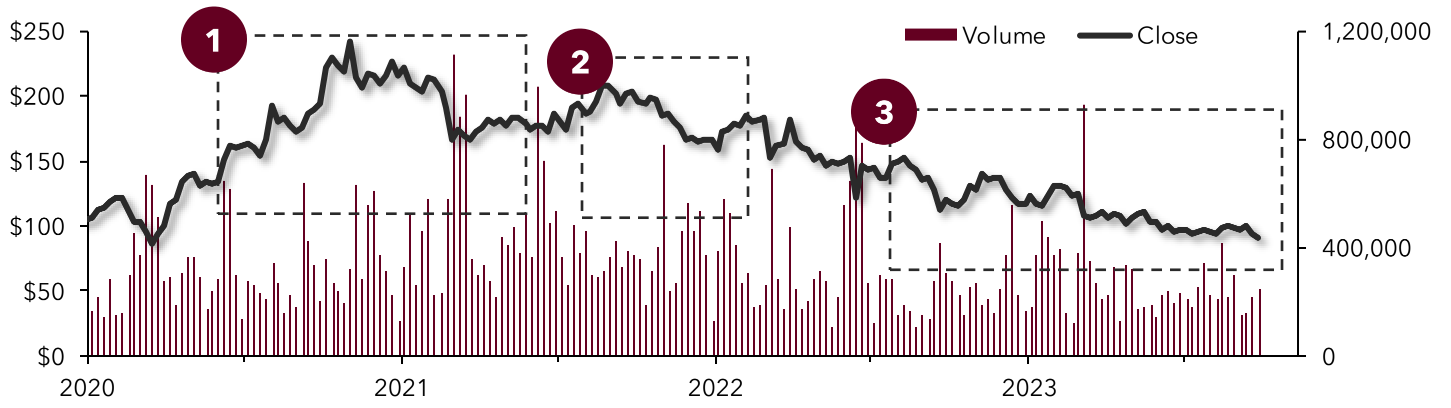
Sources: CJT 2022 Investor Presentation, Company Filings, Flying Magazine, Laurentian Bank Securities, RBC Capital Markets, Tegus

[1]B757-200 is "Narrow-body," B767-300 is "Wide-body," B767-200 is "Baby wide-body," and B777-200 is "Long-range Wide-body"; [2]Growth CapEx pulled from RBC ER (missing 2019 figure)

Strong Secular Tailwinds Amid Market Over-Correction

As demand stabilizes post-COVID, mgmt. is shifting focus to cost optimization to maximize short-term domestic revenue growth; new opportunities in e-commerce allows for greater scheduling and route utilization, reducing downtime costs as the company invests into longer-haul freighters for the LT

CJT's Historic Share Price Performance



1. 90% of air cargo move from passenger bellies onto dedicated freighters during COVID, generating one-time revenue as demand for face masks, PPE, and vaccine shipments surges
2. International route expansion temporarily drives share price up as travel restrictions ease and industry cools from non-recurring COVID revenue
3. UA, American Airlines, and Delta report 25-30% less cargo revenue, on average; investor concerns spike and CJT stock is punished due to missed EPS for consecutive quarters

Cost Optimization Tactics to Maximize Domestic Revenue

1. During the re-stabilization of air cargo demand in a capacity-constrained industry, **mgmt. is shifting focus to optimizing costs** in the short-term while investing into growth capex in the long-term
2. Apart from traditional line-items like fuel and labor, downtime is one of the most significant cost drivers: **1-2 hours of downtime** can cost an airline **$10,000 to $15,000**
3. Current capex is expanding on long-haul freighters to capture **transcontinental route opportunities** that are **higher margin per flight** (more airtime, less downtime)

Select Equity Research

"Management sounded more confident than in recent times as cost take-out efforts are paying off and the company is expecting normalization in consumer spending shift (between goods and services) by yearend."
~Scotiabank, Aug '23

"Management expects the EBITDA margin to expand sequentially, with an improving cost structure positioning the Company to deliver a better margin profile once volume trends normalize"
~ATB Capital Markets, Aug '23

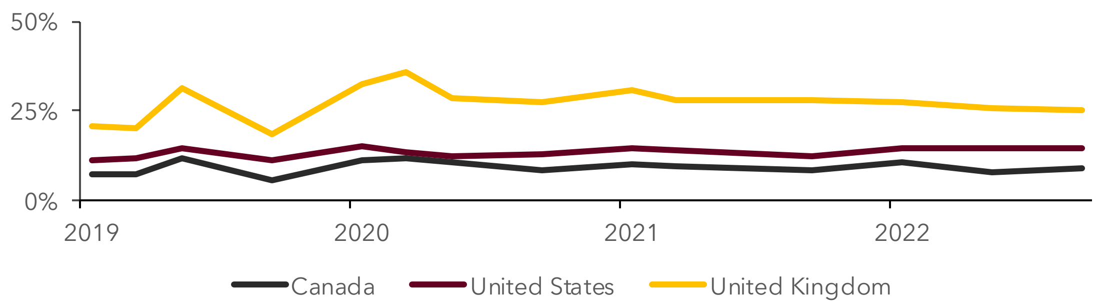
Sources: ATB Capital Markets, Company Filings, Equity Research, Scotiabank, Tegus Interviews

Investment Thesis II: Domestic and International Runways to Growth (2/2)

Runways to Growth in Latin America

Though the market opportunity for e-commerce logistics in China is highly saturated with FSC and multinational carriers, CJT's current fleet (payload capacities, haul distance capabilities) is well aligned to capture accelerating international demand for e-commerce within Latin America

E-Commerce as a % of Total Retail Sales



After securing key relationships domestically, management is now turning to higher international volumes of e-commerce, offering new runways to growth

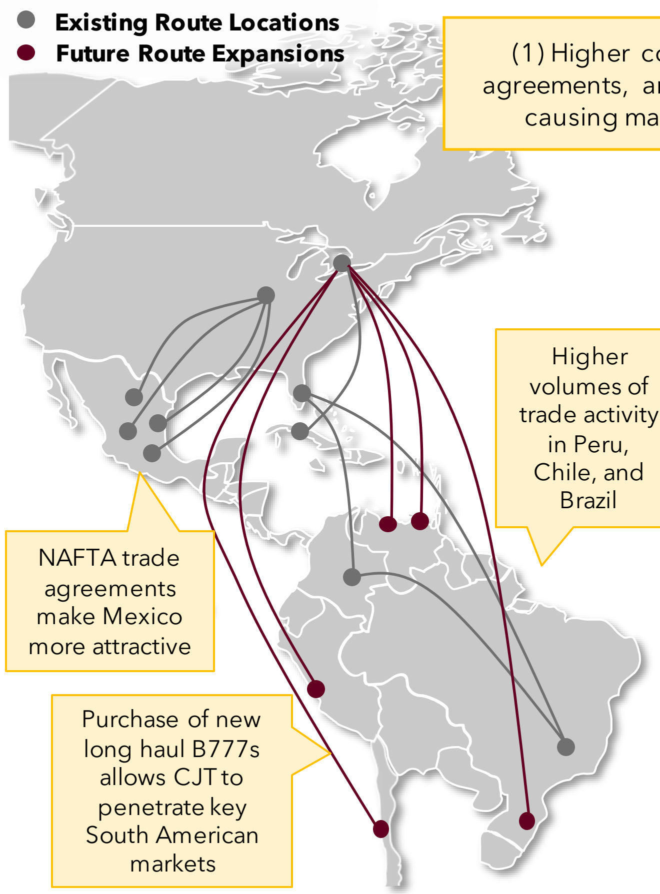
Example: United States CHIPS Act

1. $50B was invested into the US CHIPS Act to boost research and development of micro-processors within the United States

2. Critical raw materials are abundant in Latin America and trade agreements between Panama, Costa Rica and the US increase overall production in South America

3. Semiconductor market in Latin America expected to reach overall CAGR of 8.6% as market volume increases from US$17.6 to US$24.5B from 2023 to 2027

The Latin America Market Opportunity



NAFTA trade agreements make Mexico more attractive

Purchase of new long haul B777s allows CJT to penetrate key South American markets

Higher volumes of trade activity in Peru, Chile, and Brazil

(1) Higher cost of production, (2) waning trade agreements, and (3) rising geopolitical tensions are causing manufacturers to move out of China

54% increase in foreign investments make South America an attractive manufacturing location amid shoring & friend shoring acts

~400 North American companies are currently exploring moving operations from Asia to Mexico as export value across Latin America is expected to add an incremental $78B per year

CJT is poised for growth as 54 international alliances and a 5-year DHL contract positions the company well to increase international revenue streams

Sources: Company Filings, Inter-American Development Board, Tegus Interviews

Value Creation

ACMI Segment as a Vector of Outsized Growth

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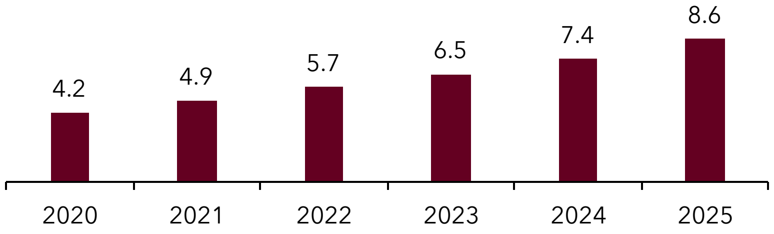
Cargojet can seek to capitalize on the rapidly growing international e-commerce opportunity through aircraft, crew, maintenance, and insurance, the proliferation of which drives positive structural business changes

E-Commerce as a Continued Driver of Cargo Demand

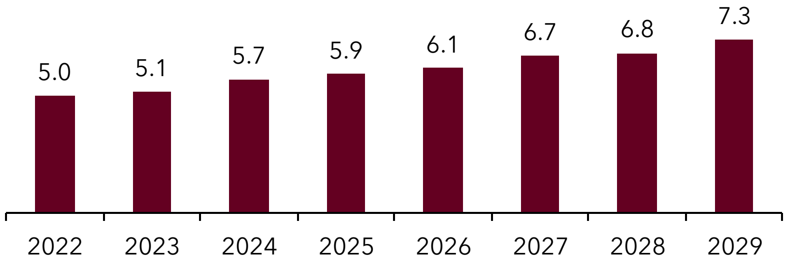
With **80% of cross-border e-commerce carried by air transport,** rapid growth in e-commerce segments is poised to create outsized demand for ACMI contracts, further exacerbating existing supply/demand imbalances and capacity constraints

E-Commerce Revenue Growth ($USDB)



Market CAGR of **16% through to 2025**

ACMI Market Value ($USDB)



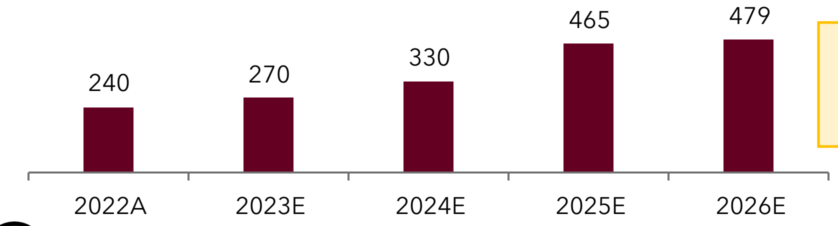
Market CAGR of **5.7% through to 2029**

ACMI as a Vector of Growth

ACMI leasing arrangements decreased during the pandemic, as constrained freighter **supply meant that all available capacity was** dedicated to chartered flights for **medical supplies**; now, E-Commerce giants **are continually looking to ACMI** for its **adaptability to capacity needs**

Cargojet will be the beneficiary of this trend as **i) block-hour usage increases amongst existing partners,** and ii) an expansion of ACMI fleet drives additional contract-wins with Transpacific capacity

CargoJet ACMI Proj. Revenue ($Cmm)



19% Revenue CAGR

1. **Increased ACMI penetration** will drive **margin** expansion for Cargojet, as incremental ACMI flights will be on **higher utilization** transpacific and international routes
2. The expansion of ACMI as a proportion of overall revenue drives **cost predictability and stability**, with **minimum guaranteed revenues** and the customer bearing all **costs of operation**

Sources: CJT 2022 Investor Presentation, Company Filings, MMR, RBC Capital Markets

Post-COVID Rebound: Poised for an Inflection

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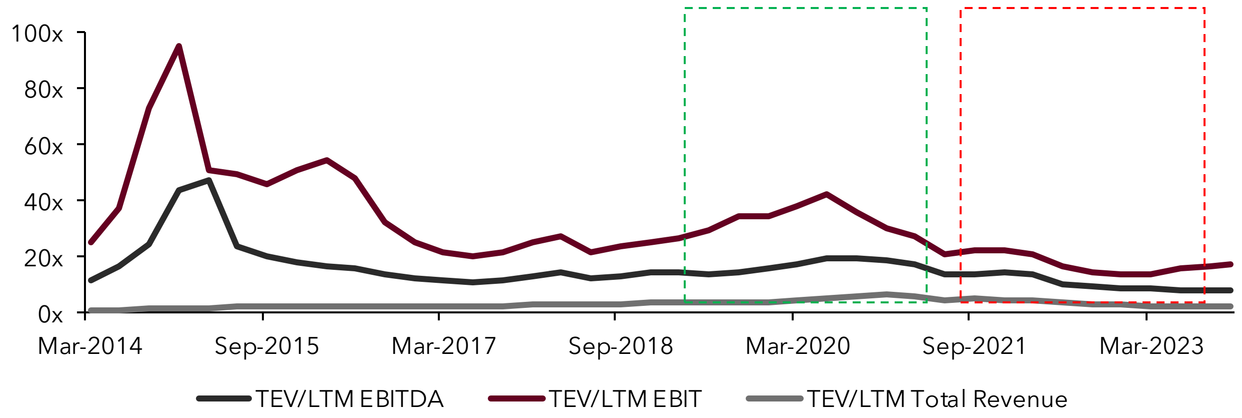
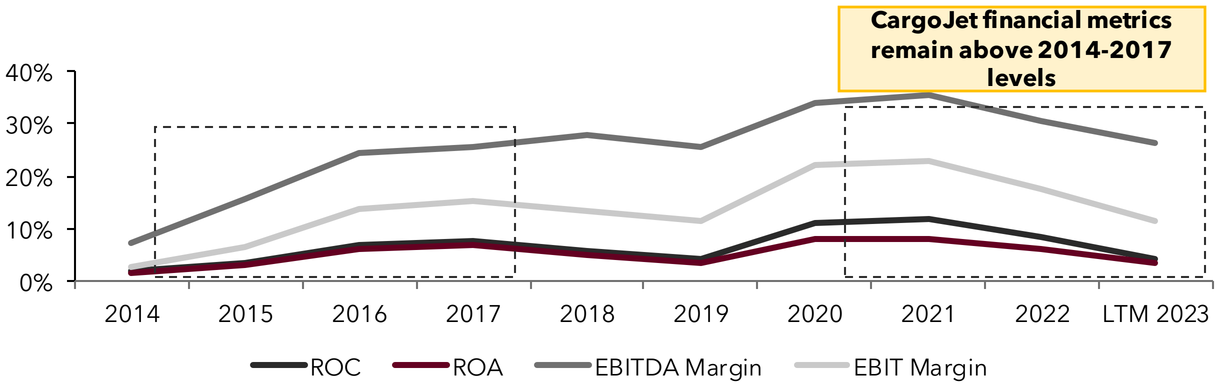
Cargojet was bid-up during the pandemic as a supply/demand mismatch and ultra-high utilization drove superior results; since then, the company has had its EV/EBITDA multiple depressed to 8-year lows despite minimal hindrance to its historic ability to generate return on capital

Historical Valuation Multiples

CargoJet Historical Multiples 2014-2023



Key Financial Information 2016 - LTM 2023



The Narrative

Cargojet was bid up tremendously during the pandemic as investors flocked to cargo freight carriers who saw revenues bolstered by **PP&E orders and ultra-high aircraft utilization rates**

Cargojet went FCF positive, with EV/EBITDA reaching a high of ~20x in December of 2020; at the same time. Cargojet spent considerably to ensure ballooning demand could be met

Softening pandemic-driven demand, coupled with ballooning expenses, drove margins down slightly in 2022; investors lost confidence and the EV/EBITDA multiple dropped to a 10-year low

Cargojet's post pandemic **multiple contraction** was a market overreaction to **slight margin-contraction driven by pandemic-induced overspending**

Cargojet has seen no deterioration of its fundamentals (see investment merits), but nonetheless trades at a multiple reflective of its 2015 performance: we believe **route optimization and cost-trimming will lead to expansion reflective of business quality**

Sources: ATD Capital Markets, CJT 2022 Investor Presentation, Company Filings, RBC Capital Markets, S&P Capital IQ

Valuation

Operating Model

- Illustrative Operating Model Forecast reflects slightly higher revenue growth than street, accounting for increased growth prospects derived from PE ownership, as well as sustained EBITDA margins that are slightly above historical, but still average with street due to a lack of increase in later years

	Historical	Illustrative Forecast				
	LTM	2024E	2025E	2026E	2027E	2028E
Revenue	922.6	1,014.9	1,116.3	1,228.0	1,350.8	1,485.9
% Growth	-5.8%	10.0%	10.0%	10.0%	10.0%	10.0%
Cost of goods sold	739.1	710.4	781.3	860.7	949.6	1,049.1
(-) COGS	*80.1%*	*70.0%*	70.0%	70.1%	70.3%	70.6%
Gross profit:	**183.5**	**304.5**	**335.0**	**367.3**	**401.2**	**436.8**
% Margin	*19.9%*	*30.0%*	*30.0%*	*29.9%*	*29.7%*	*29.4%*
(-) SG&A	(77.8)	(81.2)	(89.3)	(98.2)	(108.1)	(118.9)
% Sales	*8.4%*	8.0%	*8.0%*	*8.0%*	*8.0%*	*8.0%*
Cost saving synergies	-	-	-	-	-	-
Cost savings as % of SG&A	-	*0.0%*	0.0%	0.0%	0.0%	0.0%
Total Operating Expenses	(77.8)	(81.2)	(89.3)	(98.2)	(108.1)	(118.9)
Other Income / Expense	32.7	50.0	50.0	50.0	50.0	50.0
EBITDA:	**279.7**	**376.7**	**414.4**	**455.8**	**501.4**	**551.5**
% Margin	*30.3%*	*37.1%*	*37.1%*	*37.1%*	*37.1%*	*37.1%*
Depreciation	174.0	153.4	168.7	186.8	208.3	233.6
Amortization	-	(3.0)	(3.0)	(3.0)	3.0	(3.0)
Amortization of intangible assets	-	(25.3)	(25.3)	(25.3)	(25.3)	(25.3)
Total D&A	174.0	125.2	140.4	158.5	186.0	205.3
EBIT:	**105.7**	**251.5**	**274.0**	**297.3**	**315.4**	**346.2**
% Margin	*11.5%*	*24.8%*	*24.5%*	*24.2%*	*23.3%*	*23.3%*
Interest income	-	2.1	5.5	9.5	14.0	19.5
Interest expense	(53.1)	(97.3)	(97.3)	(97.3)	(97.3)	(97.3)
Net interest	(53.1)	(95.2)	(91.7)	(87.7)	(83.3)	(77.8)
EBT:	**52.6**	**156.4**	**182.2**	**209.6**	**232.1**	**268.4**
% Margin	*5.7%*					
Income tax expense	(10.5)	(22.0)	(25.7)	(29.5)	(32.7)	(37.8)
Tax Rate	*12.3%*	14.1%	*14.1%*	*14.1%*	*14.1%*	*14.1%*
Net Income:	**74.8**	**134.3**	**156.5**	**180.0**	**199.4**	**230.5**

Increasing usage of Cargo airliners to move freight, as opposed to in the belly of passenger flights, will drive above average revenue growth

COGS as a % of revenue were projected to remain constant

Cargojet records depreciation in COGS, so to calculate EBITDA, D&A must be added-back to gross margin. Since depreciation as a % of revenue is increasing throughout holding period, **COGS as a % of revenue increases by a proportional amount**

SG&A held constant based on 5-year historical

Depreciation was projected using a depreciation schedule; Cap-ex (projected as a % of revenue) is the main driver. PPE was depreciated **based off the useful life of commercial airplanes** (~12 years), while Cap-ex was depreciated using a mix of airplane and land facility useful lives (~20 years)

Since Cap-ex was the driver, which remained constant, **depreciation increases as a % of revenue** due to its cumulative nature

Returns and Final Valuation

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- With infrastructure & transportation having historically lower LBO returns, CJT represents a strong investment opportunity for a 5-year hold period, however, it trades slightly higher than its peers

	Estimates				
Period Ending	2024	2025	2026	2027	2028
PP&E at beginning of year:	1,689.0				
CAPEX at beginning of year:	253.7	279.1	307.0	337.7	371.5
Streight line depreciation:					
Years (PP&E):	12.0				
Years (CAPEX):	20.0	20.0	20.0	20.0	20.0
Existing PP&E:	140.8	140.8	140.8	140.8	140.8
2024 CAPEX:	12.7	14.0	15.3	16.9	18.6
2025 CAPEX:		14.0	15.3	16.9	18.6
2026 CAPEX:			15.3	16.9	18.6
2027 CAPEX:				16.9	18.6
2028 CAPEX:					18.6
Total straight line depreciation:	153.4	168.7	186.8	208.3	233.6
Amortization:	3.0	3.0	3.0	3.0	3.0
Amortizaion of identifiable intangible assets:	25.3	25.3	25.3	25.3	25.3
Total depreciation and amortization:	**181.7**	**196.9**	**215.1**	**236.6**	**261.9**

	At-Close	Illustrative Forecast				
($ in mm)	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
FYE 12/31	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
	2023-12-31	2024-12-31	2025-12-31	2026-12-31	2027-12-31	2028-12-31
LTM Adj. EBITDA	**$280**	**$377**	**$414**	**$456**	**$501**	**$552**
Multiple	9.5x	9.5x	9.5x	9.5x	9.5x	9.5x
Total Debt	$806	$1,621	$1,621	$1,621	$1,621	$1,621
(-) Cash	($43)	($40)	($112)	($197)	($293)	($411)
Net Debt	**$764**	**$1,581**	**$1,510**	**$1,424**	**$1,329**	**$1,210**
Enterprise Value	$2,664	$3,588	$3,947	$4,342	$4,776	$5,253
Equity Value	$1,939	$2,007	$2,437	$2,917	$3,447	$4,043
Equity Ownership	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%
Equity Proceeds						
2024	($775)	$803				
2025	($775)	$0	$975			
2026	($775)	$0	$0	$1,167		
2027	($775)	$0	$0	$0	$1,379	
2028	($775)	$0	$0	$0	$0	$1,617
MOIC		**1.0x**	**1.3x**	**1.5x**	**1.8x**	**2.1x**
IRR		**3.5%**	**12.1%**	**14.6%**	**15.5%**	**15.8%**

Commentary

- Depreciation is projected based off a Cap-ex schedule, thus why depreciation is increasing as a % of revenue
- Cargo Jet's significant asset base enables it to receive attractive financing amid a high interest rate environment, as it has significant collateral that is easily liquidated in the event of a cash short-fall
  - Model assumes 6% interest rate on leverage, which is slightly lower than average PE rates, however in-line with infrastructure-related projects
    - **Final Investment Return: 5-year holding period yielding a 2.1x MOIC and 15.8% IRR**

Risks & Mitigants

Cargojet Enables Strong Returns With Mitigated Risks

Cargojet possesses a strong risk/return profile which enables it to act as a leader in the overnight air cargo industry. The company's existing positioning and strong history enable it to capture market growth while mitigating potential risks.

Risks

Loss of Customer Contracts – High customer concentration with ten largest customers making up ~80% of revenues

Airline Industry Regulation – Subject to complex aviation and transportation regulations

Competition – Customers switching to other overnight air cargo providers or vertically integrating

Supply Constraints – Limit cargo carriers' ability to meet demand growth, increased emphasis on overnight shipping

Mitigating Factors

Investments & Operational Excellence

- Cargojet has made material investments in its fleet, equipment and the hiring of new personnel – ensuring contract requirements are met
- Renewal of Canada Post and Purolator contracts serve as example

Strong Track Record of Compliance

- Cargojet is routinely audited by various regulatory bodies including Transport Canada and the Canadian Transportation Agency to ensure compliance with all flight operation and aircraft maintenance req.

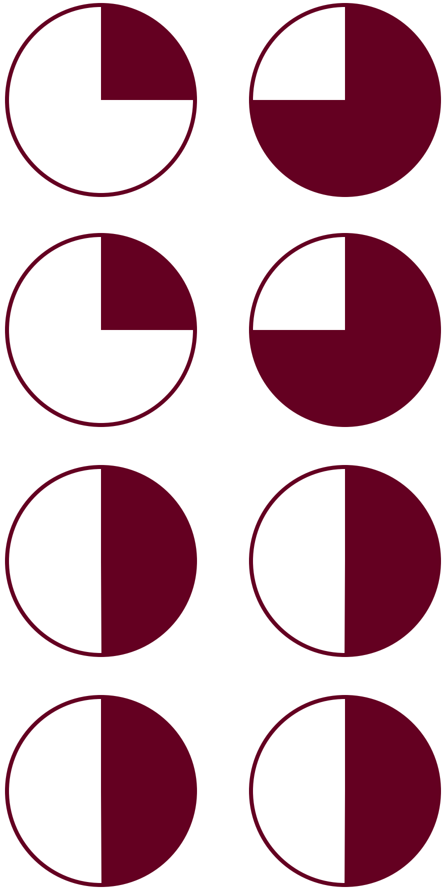
Strategic Agreements with High-Profile Customers

- Cargojet has agreements with companies such as Amazon and DHL where they have issued warrants that vest over the course of seven years and are dependent on delivery and volume targets

Increased WTP Within Major Cargo Player

- Dominant players with deep-rooted existing cargo customer partnerships (i.e., CargoJet & Amazon) will be able to afford premiums for new freighters

Realization/Impact



Source(s): Company Filings, IBIS World, Equity Research