Cargojet

Industrials
TSX: CJT
Market Outperform | Buy

Calgary Portfolio Management Trust

March 31, 2024

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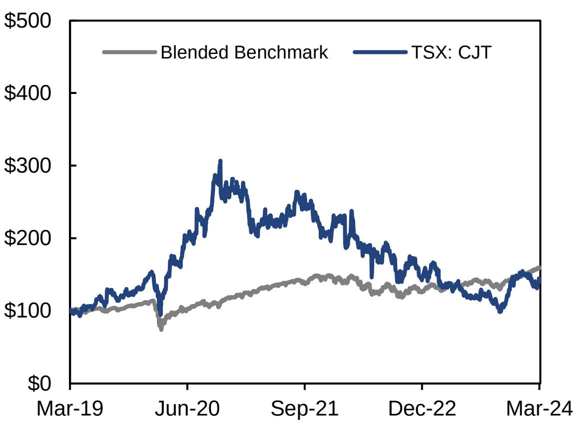
Return on Investment	
Current Share Price	$111.90
Target Price	$146.00
Dividend Yield	1.00%
Implied Return	31%
Conviction Rating	1

Market Profile	
52-Week Range	$76.50 - $124.94
Market Capitalization (US$mm)	$1,887
Net Debt (US$mm)	$767
Enterprise Value (US$mm)	$2,654
Beta (5-Year Monthly)	1.03

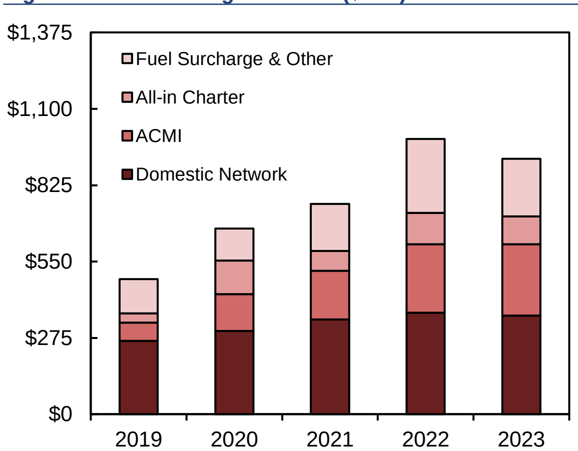
Metrics	2023A	2024E	2025E
Revenue (US$mm)	$878	$958	$995
EBITDA (US$mm)	$301	$325	$344
EPS	$2.06	$3.64	$4.72
EV/EBITDA	8.8x	8.2x	7.7x

Historical Trading Performance (Indexed to $100)



Source: S&P Capital IQ

Figure 1: Revenue Segmentation ($mm)



Source: Company Filings

Business Description

Cargojet (TSX: CJT) is a Canadian-based air-cargo carrier providing various domestic and trans-border air freight services across 16 major Canadian airports. CJT operates in three segments: (1) Domestic Network Air Cargo, (2) Aircraft, Crew, Maintenance, & Insurance (ACMI), and (3) All-in Charter. The Company operates a fleet of 41 all-cargo aircraft, transporting over 25mm pounds of time-sensitive air cargo per week through over 80 domestic flight legs.

Domestic Air Network: CJT operates a network of all-cargo aircraft that facilitate express deliveries on behalf of integrated carriers and e-commerce firms. Shippers pre-purchase guaranteed space and weight allocations on the Company's network under long-term contracts, with any unutilized capacity sold on an ad-hoc basis. The Domestic Air Network comprised 41% of FY 2023 revenues, with ~75% under long-term contracts.

ACMI: CJT provides aircraft and crew leasing to integrated freighters and e-commerce companies on a contracted and ad-hoc basis. Currently, 15 aircraft are under long-term contracts with DHL (ETR: DHL), flying routes between Cincinnati and major Canadian cities. ACMI contributed to 29% of FY 2023 revenues.

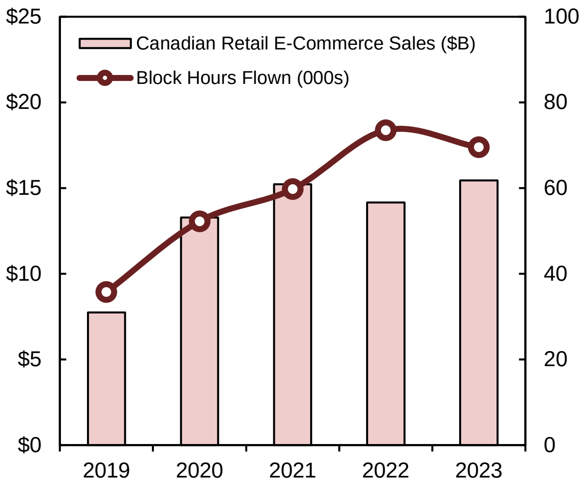
All-in Charter: CJT provides specialized cargo services solely on an ad-hoc basis. Specialized cargo can include hazardous, oversized, urgent, or emergency response shipments. The charter business does not have dedicated aircraft; instead, it utilizes excess fleet capacity from the Domestic Air Network and ACMI businesses. All-in Charter comprised 11% of FY 2023 revenues.

Fuel Surcharge & Other: CJT recognizes fuel surcharges from customers with 100% variable pass-through cost contracts from its three operating segments. Other surcharges include inflation, navigation, and any uncontrollable costs. Surcharges and other revenues comprised 19% of FY 2023 revenues.

Industry Overview

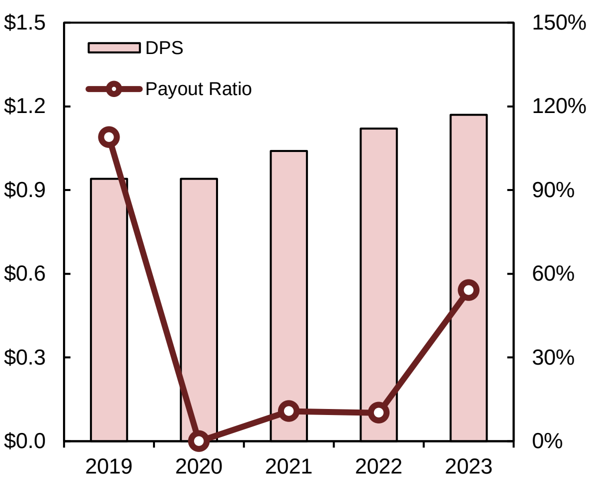
Air cargo operators are classified into four main types: (1) Integrated Carriers, which operate large, international fleets of scheduled aircraft, trucks, and couriers for door-to-door deliveries; (2) All-Cargo Freighters, which operate exclusively cargo aircraft in airport-to-airport networks; (3) Combined & Commercial Passenger Airlines, which use the capacity in the belly of commercial flights to ship cargo between airports, and (4) Contract or Regional Freighters, which operate through smaller or remote airports, contracted on behalf of integrated carriers. Major integrated carriers in Canada, such as DHL, FedEx (NYSE: FDX), and UPS (NYSE: UPS), almost exclusively fly international and trans-border routes between their U.S. logistics hubs and select Canadian airports. After cargo is unloaded, regional airlines are contracted to distribute and consolidate cargo from smaller markets for the return flight to the integrated carrier's hub. Contract airlines in Canada include Norlinor Aviation, Morningstar Air Express, and Buffalo Airways. CJT is Canada's only all-cargo freighter, contributing to ~90% of domestic air shipping volumes. Air Canada (TSX: AC) and WestJet service international routes and remaining domestic volumes through a combination of passenger and freighter aircraft.

Figure 2: LHS Block Hours vs RHS E-commerce Sales



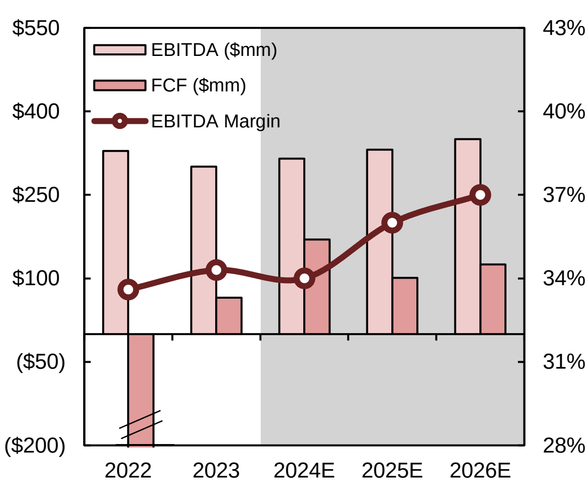
Source: Company Filings, Statistics Canada

Figure 3: LHS DPS vs RHS Payout Ratio



Source: Company Filings

Figure 4: LHS FCF & EBITDA vs RHS EBITDA Margin



Source: Company Filings, CPMT Estimates

Global Shipping & Freight

Air cargo yields have experienced strong growth in Q1 2024 due to international supply chain disruptions following the Russia-Ukraine war and the Red Sea Crisis. Air shipping rates remain ~30% above pre-pandemic levels after experiencing a ~50% decline over 2023 due to a recovery in capacity from passenger flights' belly cargo. In Q1 2024, air freight volume measured by cargo tonne-kilometers (CTKs) exhibited a 12% YoY expansion. CTK growth is anticipated to continue throughout 2024, driven by robust e-commerce demand and manufacturing output. As such, air freighters' revenues are expected to recover from the turbulent environment of the previous year. Additionally, Boeing (NYSE: BA) plans to halt B767 production in 2026, placing additional pressure on available CTKs. This presents near-term tailwinds for domestic air cargo operators with large fleets.

Mandate Fit

Quality Management: Pauline Dhillon and Jamie Porteous have shared the roles of Co-CEO since January 2024, which followed Dr. Ajay Virmani's transition from CEO to Executive Chairman. Virmani, Dhillon, and Porteous founded the Company in 2001 and have grown CJT from a startup to Canada's largest air freighter over the last 22 years. Dhillon served as Chief Corporate Officer since 2020, while Porteous served as the Company's Chief Strategy Officer since 2021. Management compensation is tied to specific operational and financial targets, with at-risk pay representing 68% and 57% for CEO and NEOs, respectively.

Competitive Advantage: CJT's core operations in time-sensitive and overnight air freight are logistically complex and benefit greatly from economies of scale. The Company has long-standing relationships with major Canadian shippers, with its network contributing to ~90% of domestic air cargo volumes. CJT's dominant market share prevents other operators from gaining market share on routes serviced by CJT, notably WestJet Cargo and Air Canada Cargo. Due to the Company's scale, CJT is an industry leader in efficiency and on-time performance (OTP), with over 99% of flights arriving on time and in full. CJT's high OTP and reputation for reliability allow the company to commit a significant portion of the network's capacity to long-term contracts. ~75% of revenues from the domestic network are under minimum volume contracts with pass-through variable costs. Consequently, CJT has exhibited an industry-leading EBITDA margin of 34% over the last five years compared to the freighter peer average of 13%. The Company leverages its strong customer relationships to expand its ACMI business. CJT operates 18 dedicated ACMI aircraft, 15 of which are under long-term, staggered contracts. CJT's ACMI and ad-hoc charter businesses are internationally scalable, with flexibility for aircraft to be reassigned to other operating segments internally, given constrained or excess capacity.

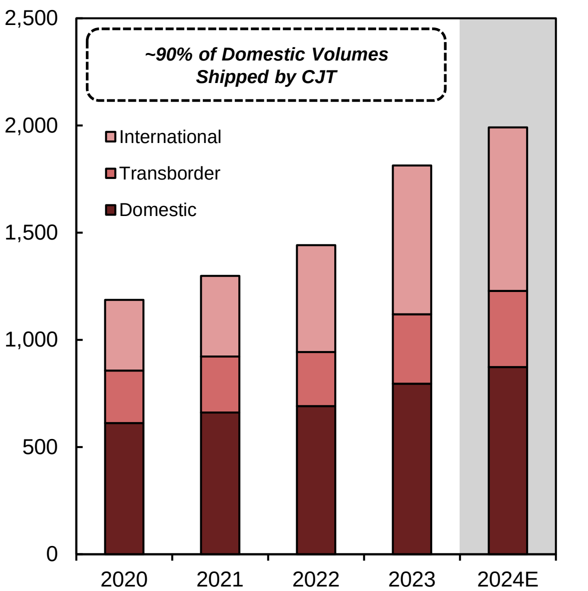
Strong Balance Sheet: CJT has a Net Debt/EBITDA of 2.4x, in line with the integrated carrier peer average. The Company has prioritized the acceleration of its deleveraging commitments after readjusting fleet expansion plans and capex in Q1 2024. CJT sold four production slots in B777 freighter conversions, following the sale of four B777 aircraft during 2023 due to a downturn in freight activity, freeing up $739mm in capex. CJT is targeting 1.5x to 2.5x Net Debt/EBITDA over the next three years and forecasts a 2024 capex of $160 - $180mm. CJT has been historically prudent with capital allocation, preferring organic growth opportunities through fleet expansions and additional network service over M&A.

Figure 5: 2024E Fleet Breakdown

Aircraft	Payload (lbs)	Leased	Owned	Network Capacity (lbs)
B767-300 ER	125,000	4	17	2,625,000
B767-200 ER	100,000	1	3	400,000
B757-200 ER	84,000	0	15	1,260,000
Total		**5**	**35**	**4,285,000**

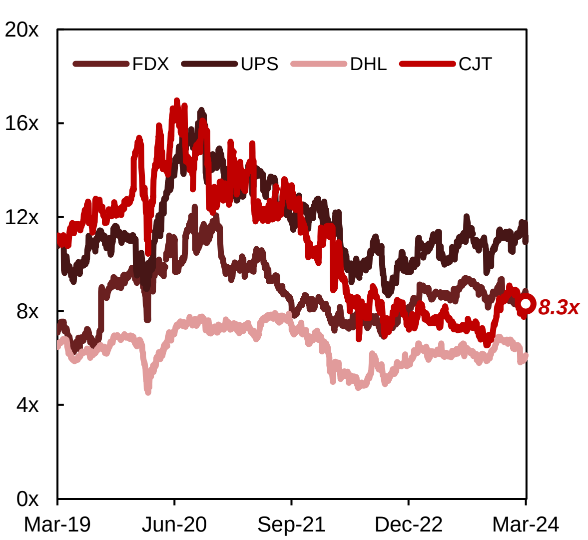
Source: Company Filings

Figure 6: Canadian Air Cargo Volumes ('000 tonnes)



Source: CPMT Estimates, Statistics Canada

Figure 7: NTM EV/EBITDA vs Peers



Source: S&P Capital IQ

Growing Free Cash Flow: Despite industry-wide challenges, CJT has grown FCF at a 6% five-year CAGR due to the Company's focus on cost and margin management. Dividends per share have also grown at a consistent 7% five-year CAGR. Long-term domestic network contracts contribute to the stability of the Company's cash flows, as increased operating costs from inflation, fuel, and other uncontrollable costs are passed through to the customer. Management expects margin expansion over the next three years resulting from volume recoveries, with the ability to increase fleet capacity by 15 - 20% by changing underlying flight schedules. Due to CJT's B777 sales and capital allocation refocus, the Company is entering a strong FCF generation phase focusing on dividend growth and continuing share repurchases. CJT has repurchased over 0.6mm shares on its current NCIB, with ample capacity to repurchase the remaining 0.9mm shares following the B777 sales.

Catalysts & Risks

A primary revenue driver for air cargo is business-to-business (B2B) and business-to-consumer (B2C) e-commerce. Canadian e-commerce volumes are expected to grow at a 16% five-year CAGR, with ~80% of these volumes shipped by air in 2023. Logistics efforts from Amazon (NYSE: AMZN) have contributed to over 90% of consumers expecting domestic shipping within 2 - 3 days. These volumes can only be supported by air cargo given Canada's low population density. Additionally, COVID-19 catalyzed the growth of time-sensitive air shipping, as pharmaceuticals and humanitarian aid shipments became necessary for the operation of hospitals and research facilities around the globe. These factors combine to create a favourable environment for domestic freighters.

A prominent risk to CJT's business model is volume sensitivity in high pass-through cost environments. If e-commerce firms or their customers cannot justify the costs of shipping goods into Canada, contracts with CJT's main counterparties could be left un-renewed. High jet fuel prices, inflation, and currency devaluation could lead to potentially unprofitable routes. As seen in 2023, publicly listed freighters saw 25 - 60% decreases in revenues, partially attributable to lower-than-expected consumer spending during the holiday season. Additionally, amendments to the U.S.-Canada *Open Skies Agreement* could jeopardize CJT's contracts with U.S. Carriers. The *Open Skies Agreement* allows airlines to establish direct links between airports on either side of the border. CJT relies on this regulation as it prevents U.S. integrated carriers from establishing domestic routes within Canada. A liberalization of this policy in could lead to increased competition from integrated carriers, threatening CJT's market share.

Investment Thesis and Valuation

CJT was valued at $146 using a five-year DCF with a WACC of 10.0%. The terminal value was determined using a 50/50 blend of (1) the Gordon Growth method, using a terminal growth rate of 2.0%, and (2) applying an EV/EBITDA exit multiple of 9.5x.

The CPMT favours CJT's dominant market share in domestic air freight in addition to its significant competitive advantage in time-sensitive logistics. The Fund views CJT as trading at an attractive valuation of 8.3x NTM EV/EBITDA relative to the peer average of 9.0x. With strong secular tailwinds in B2B and B2C E-commerce, CJT is poised to benefit from industry-leading EBITDA margins in the Domestic Network and ACMI segments while carrying significant downside protection through long-term contracted minimum revenues and flexible fleet chartering.