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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Cargojet conference call.

I would like to turn the meeting over to Ms. Pauline Dhillon. Please go ahead, Ms. Dhillon.

Pauline Dhillon, Executive Vice President Marketing, Public Relations, and Government Relations

Thank you, Marie. Good morning, everyone, and thank you for joining us today for our First Quarter 2023 Results.

With me on the call today are Ajay Virmani, our President and Chief Executive Officer; Jamie Porteous, our Chief Strategy Officer; Scott Calver, our Chief Financial Officer; and Sanjeev Maini, our Senior Vice President Finance. After opening remarks about the quarter, we will open the call for questions.

I would like to point out that certain statements made on the call, such as those relating to our forecasted revenues, costs, and strategic plans are forward looking within the meaning of the applicable securities laws. This also includes references to non-GAAP measures, like Adjusted EBITDA, adjusted earnings per share, and return on invested capital. Please refer to our most recent press release and MD&A for important assumptions and cautionary statements relating to forward-looking information and for reconciliation from non-GAAP measures to GAAP income.

I will now turn the call over to Ajay for his remarks.

Ajay Virmani, President and Chief Executive Officer

Thank you, Pauline. Good morning, everyone, and thank you for joining us on our first quarter earnings call.

Given the tough industry and macroeconomic backdrop, we are pleased with our stable Q1 performance. Another factor that has had a disproportionate impact on our volumes is the shift in consumer spending away from goods to spending on travel and leisure activities during the post pandemic period. Consumers were not able to travel or go to restaurants, theatres, or movies during the past two years of COVID. We are seeing a higher proportion of disposable income being spent on travel and leisure activities versus pre-pandemic levels. We expect this mix to normalize in the later part of this year.

Our strategic decision to place a high conviction bet on building ACMI business has allowed us to soften the volatility of earnings despite a challenging economic environment and a lopsided consumer spending mix. ACMI business now accounts for one-third of overall revenues.

Let us now touch on the more immediate task of managing in a challenging economic environment. Softer industry results as well as the challenging macroeconomic data remain a major headwind for our

business. Despite the recent downward trend in the inflation rate over the last few months, we do not expect interest rates to decline in the near term.

Therefore, we are focusing hard on our cost management across the entire business, and more specifically, number one, working closely with our largest customers to right-size our network to reduce block hours while maintaining delivery standards. Block hours is a key driver of our direct costs, and if we can find opportunities without sacrificing services, we can drive efficiencies.

Number two, identifying opportunities for four to five surplus B757 aircrafts for ACMI contracts or dry lease options. We believe these actions will significantly offset aircraft costs and depreciation expense.
Number three. With our second flight simulator coming online in Q3 of this year, we plan to operationalize 100 percent of the pilot training in Hamilton, our hub. This will result in significant cost savings in travel, hotel, and crew expenses.

Number four. With a greater ability to plan our maintenance schedule, we are targeting a significant improvement in our maintenance productivity. Given the hectic (inaudible) flying over the past few years, such planning was suboptimized.

Number five. We have eliminated all temporary labour in our operational areas and are targeting zero overtime goal.

Number six. We are reviewing every line item and focused on reducing overall expenditures in all areas and have frozen nonessential hiring.

Our cost reduction initiatives are in the early stages of implementation. We expect to see additional benefits from these in the coming quarters.

On the capital expenditure side, at the last quarter call, we shared our desire to exercise options to delay aircraft conversions. We are exercising the optionality to better align the timing of capital expenditures closer to the planned conversion dates of aircraft scheduled to support future growth. We are going to be targeting significantly lower CapEx in 2023 than previously announced. Scott will give you more details on our CapEx spend.

Despite a challenging economic environment, we remain focused on identifying new revenue opportunities and are aggressively pursuing new ACMI and ad hoc charter opportunities. We believe we can help our customers further streamline their network.

We'll continue to strike the right balance between cost management and staying prepared for opportunities when the tide turns. It is a delicate balancing act. Training pilots and maintenance personnel takes time. Likewise, securing aircraft and bringing them on our certificate (phon) and making them operational takes time. For a highly capital-intensive business, long-term planning is just as important as the short-term cost reduction.

With a strong balance sheet and a solid liquidity position, Blue Chip portfolio of customers and partnerships, and a superior on-time track record, we are well positioned to weather this storm. While we cannot predict the economic cycles, our business model remains resilient, and long-term macro trends that drive our business remain intact. We expect to resume a growth trajectory as soon as the economy turns the corner. With a strong, committed team, we remain focused on executing on our long-term strategy and creating shareholder value.

I will now pass on the call to our CFO, Scott Calver, for an update on the business.

Scott Calver, Chief Financial Officer

Thank you, Ajay. Good morning, everyone.

I'll first build on what Ajay just previously mentioned as it relates to our balance sheet and update for our planned capital expenditures.

In the last quarter, we had a subsequent event note outlining the opportunity to sell the feedstock for two Boeing 777s to support general growth. For this current reporting period, you will see assets held for sale on our balance sheet. This includes the two 777s from the fourth quarter, and we've added a third 777. If you go back to the third quarter last year, you'll remember that we exercised our option for one 777. This one 777 from the third quarter last year and the three that we have disclosed on our first quarter balance sheet completes the deferral of four 777s for general growth. We have not changed our plans for the first four 777s, as these are essential to support customer requirements, or what we refer to as strategic revenue growth. We have not canceled any of our conversion slots for both strategic and general revenue growth. At this time, we still believe that these are essential to support Cargojet's long-term growth strategy, and we are confident that future feedstock can be acquired closer to the scheduled conversion dates under similar terms and conditions. As Ajay mentioned, we continue to work closely with our customers, and we will manage our fleet size accordingly.

In the short term, a reduction in noncash depreciation expense does not align with our goal to maintain flexibility to provide exceptional customer service for various scenarios as required, or potentially required, by our

customers. Having said that, we are pursuing an expansion of short-term dry leasing opportunities to enhance earnings.

An update on our profitability and our cost management initiatives. We are pleased with closing the quarter with $75 million in EBITDA despite an $8 million reduction compared to the prior year which was largely driven by crew depreciation and a one-time extraordinary event last year with emergency COVID ad hoc charters from Asia.

Our domestic overnight revenues at $84 million were almost flat to prior year, but it is worth noting that the average quarterly revenue pre-COVID was $66 million. This is a baseline lift of 27 percent.
Our ACMI revenue for the quarter was $65.7 million versus a pre-COVID average of $16.6 million, a lift of approximately 300 percent over a three-year period. At $20 million, our all-in charter business remains steady given the overall soft demand after the COVID peak.

It was a one-time opportunity for charters last year with a reported revenue of $43.5 million. Since then we have indicated that normalized charter revenue would be in the range of $15 million to $20 million per quarter, so we are pleased with charter revenue coming in at just over $20 million for the first quarter in 2023. As for the impact to gross margin, the pricing last year for these emergency charters in an environment of constrained capacity was significantly more attractive compared to the typical market conditions that currently exist.

For crew costs, there is a five-month lag to have a pilot fully trained and released into our schedule. We do not have enough capacity in Hamilton with our new 767 flight simulator. Therefore, the backlog of training is expensive as we outsource the training to a service provider in the United States.

While the pilots are in training, the overtime is high for our existing pilots. The good news is that we've made significant progress in March, and the progress since then is on track with our expectations.

As for the progress on other cost management initiatives, as Ajay just said, the most significant driver of cost in our business is managing our block hours. We recently further optimized our domestic network by eliminating a direct flight between Edmonton and Hamilton. The savings from this initiative starts in the beginning of the second quarter.

The use of temporary employees has nearly been eliminated, with the exception of temporary employees that are required to support certain customer requirements that are paid for by the customer.

Cargojet continues to manage vacant positions where possible. There will always be exceptions when a vacant position needs to be filled, but generally speaking, we are making progress to align our costs to the current environment.

On a year-over-year basis, if you adjust back to prior year levels for crew costs, noncash depreciation, and further adjust for the one-time chargers in the first quarter of 2022, the gross margin is consistent to prior year.

Cargojet's adjusted free cash flow was flat compared to the first quarter last year mostly due to a reduction in maintenance capital expenditures.

We closed the quarter with our borrowings being down slightly compared to the start of the year. It is anticipated that the US$75 million sale proceeds for the first two Boeing 777s will be received in the second quarter, and this will further de-lever the balance sheet.

Cost management, along with the opportunities to better time our capital expenditures support one of our primary objectives, or what we refer to internally as our guiding North Star, our debt-to-EBITA ratio.

In conclusion, since we started down this journey to manage the business during this down cycle, we are pleased with the progress made so far. The trend lines are encouraging, and the team is committed to further improvements to achieve our short-term goals while not losing sight that the fundamentals remain strong for our long-term strategic plan.

This concludes our opening remarks, and we will now open up the call to questions.

QUESTION AND ANSWER SESSION

Operator

Thank you. The first question is from Chris Murray from ATB Capital Markets. Please go ahead, your line is now open.

Chris Murray, ATB Capital Markets

Yes. Thanks, folks, good morning. Just maybe going back a little bit, I guess the first question is on cost. Can you guys maybe elaborate a little bit about some of the levers that you're working on to look at getting these margins maybe more right-sized or the cost more right-sized to the revenue profile you're thinking for the next little while?

Ajay Virmani, President and Chief Executive Officer

Well, the first thing, as I mentioned, we're looking at right sizing the network with the right fleet and eliminating block hours. The second part is we're looking at all our personnel costs over time. Third is greater focuses on procurement, our supplier costs, and any supplies we buy. So, these are the three areas that we are focused on. If you want further, we can certainly get one-on-one with it, but these are the three major drivers of cost and reduction of costs. We are working on all three simultaneously.

Chris Murray, ATB Capital Markets

Okay, and is it fair to think that—I mean, you sort of mentioned that you've been working on this now for maybe about a quarter. Is it fair to think that a lot of these initiatives will have the cost profile right size as we get into Q2 or Q3, or is it something that you think could take a little bit longer to get these changes made?

Ajay Virmani, President and Chief Executive Officer

So, because we didn't start working in the—we started these initiatives more like in the middle of the first quarter when we saw the trends and macro trends. As I said, we have to be very careful in balancing this because obviously, if demands go up, you have to be ready. You can't just on Monday morning or Tuesday get ready and handle these. We have to be very cautious in how we dismantle some of the stuff that has been built during the COVID times.

Now, I would imagine that probably another two quarters we'll see the full impact on some of the changes we are making slowly because customers are important to us and we want to maintain the service, but we also have full consultations with them when we sort of do certain changes to schedule that result in cost reductions. So yes, I would say that probably for the next two quarters this will continue on.

Chris Murray, ATB Capital Markets

Okay. My other question is on the ACMI business. There's always been some thought that this was going to be relatively resilient. I go back to the Investor Day and I think you folks mentioned that the way you're positioned with DHL that you'd probably be the most favoured client, or operator, I guess, of that service for them. Can you just talk a little bit about what you're seeing in that ACMI market and if you think that there's any further opportunity for growth, or are you just going to be able to maintain what you have at this point?

Ajay Virmani, President and Chief Executive Officer

If you look at ACMI business, it's not immune to the macro trends. I mean, whether it's the network, whether it's ACMI, when the shipping is less, the demand is less. It affects all businesses. But we can tell you that we have not had a reduction in number of planes. Yes, some block hours have been reduced by DHL. All I can tell you is that we do have a preferential strategic partnership with them and we have had the softest landing of any carriers they use. Because a number of the carriers, almost every carrier has lost planes and routes. So we, having that relationship, has certainly helped us to maintain the number of planes, and we do get opportunities from them on fill-in basis. When other carriers are going for maintenance and other things, we are the first one who gets a call on these. In the summertime, we are—or pretty soon, I think, we are starting two routes that are strictly fill-in for other carriers or maintenance issues.

So, we continue to be a preferred carrier. We continue to provide them with a service that exceeds anybody else, and we continue to service them in a way that we remain number one with them.

As the ACMI market is concerned, it goes in line with the macro trends. I can tell you that whatever the trends are, it follows every line of business, whether it's charters or whether it's ACMI.

Chris Murray, ATB Capital Markets

Okay, that's helpful. Thank you.

Operator

Thank you. The next question is from Cameron Doerksen from National Bank Financial. Please go ahead, your line is now open.

Cameron Doerksen, National Bank Financial

Good morning and thanks very much. Just a question on, I guess, the domestic network. Obviously, there's not a huge amount of visibility going out to the next couple quarters, but I'm just wondering what your sort of core customers are telling you as far as volumes. Like, what are they seeing in the market? What's kind of their

expectations for capacity needs over the next couple of quarters?

Jamie Porteous, Chief Strategy Officer

Good morning, Cameron, it's Jamie. I think, as Ajay said in the opening remarks, we're definitely seeing the global and hear domestically sort of the macroeconomic factors that are affecting all modes of transportation, are certainly affecting our domestic network. I think as we indicated to you and others going into the quarter, coming out of strong year-over-year domestic growth, we thought that the first quarter would see sort of low single-digit growth. We obviously came in flat, and I think the indications are from our customers that we'll continue to see soft demand for capacity on the domestic network for the balance of the year. That's why we've taken some of the initiatives, as Ajay noted, on the adjustments to our capacity and our schedule to meet that demand going forward.

Cameron Doerksen, National Bank Financial

Okay, that's helpful. Maybe just a second quick question. You mentioned in the prepared remarks about some potential for dry lease opportunities. Just wondering if you can expand on what these opportunities might be.

Ajay Virmani, President and Chief Executive Officer

Initially, we brought in the 757s domestically to get us some more required lift in demand that was asked of us by our customers. Also, it provided a direct service to a lot of stations to further improve our services and to take out the 767s that were higher yielding in the marketplace from ACMI and charter opportunities.

Because of the certain macro trends, as we all know, we have now continued with the 767s in domestic operation because it reduces the number of block hours and also the cost advantage. So that will free up between four and five 757s. At this point in time, where we are trying to market these as dry lease opportunities, or wet lease, or ACMI, whatever we can do, but we are actively going to be looking at these opportunities in the next coming weeks as dry lease or any other opportunities we can find those. So, there would be about four to five 757s.

Cameron Doerksen, National Bank Financial

Okay, that’s great colour. Thanks very much.

Operator

Thank you. The next question is from Kevin Chiang from CIBC. Please go ahead, your line is now open.

Kevin Chiang, CIBC

Thanks for taking my question here. Maybe just a macro question. You were pretty cautious on your Q4 earnings call in early March. Just wondering, like, are those worse than you anticipated then, or just a continuation of the cautious tone that you had in Q4 and you're just providing more granularity on some of the initiatives you're taking on the cost front here to right size the business? Or are you taking more steps than you had thought you'd be taking back in March when you provided, I guess, your initial outlook for 2023?

Jamie Porteous, Chief Strategy Officer

Good morning, Kevin, it's Jamie. I think definitely indications are that demand is softer than we would have anticipated even back in March when we were reviewing our Q4 results. As you recall, we saw Q4—for the year, as I indicated earlier to Cameron's question, I think we saw strong year-over-year growth. When I look at the domestic network, it really fell off. It was a really unique peak period for us where December, our traditional peak volumes sort of fell significantly through sort of all facets of our—all segments of our business, but particularly on the domestic demand. That made us a little bit more cautious about what our expectations were going forward.

I think initially, back in the fall, we were talking about high single-digit year-over-year growth for the domestic business. I think we tempered that in our fourth quarter earnings call to low single-digit. Our actual results being flat, we think that's an indication that we're going to be a little bit more cautious about volumes on the domestic for the balance of the year. All indications from all of our customers is pretty consistent that sort of overall consumer demand is lower than people expected, and that's why we've taken some initiatives that we addressed earlier on driving block hour costs out of our network, rightsizing the aircraft types that are operating on the domestic network, all with the goal of trying to maintain the margins that we've historically had on our business, regardless of what the revenues are.

That spills over, obviously, into the ACMI business, as Ajay just commented on, with lower demand, although we're still operating the same number of aircraft and we'll be adding additional aircraft on an ACMI basis and

should have—we'll continue to have year-over-year growth just because of the annualized impact of some of the routes that we added in 2022, although they may not be flying the same number of block hours that they did.

On the charter side, as Scott mentioned in his remarks, we were very satisfied with the ad hoc charter revenue segment in the first quarter at the high end of what we would expect, and we would expect that to continue for the balance of the year just by the nature of the fact that we have additional crew and certainly will have additional aircraft available for ad hoc charters as compared to what we would normally have during a normal year.

Kevin Chiang, CIBC

That's helpful. I know this is a difficult question to answer, but if you could right size the network the way you see fit—I know you have to have these discussions with your customers—how many excess block hours do you think you flew in Q1 versus what you think you could have flown if you were kind of maximizing—or minimizing the cost per block hour? Is there a way to think of what you see as maybe the opportunity set here to kind of adjust the network relative to maybe what you flew in Q1 just given the environment we find ourselves in today?

Jamie Porteous, Chief Strategy Officer

That's a hard question to answer, Kevin. It's an ongoing process, as you can imagine. We can't change the network on a—we can't just change it on a daily basis. We have service commitments to meet for all of our customers across the country to the 15 cities that we fly to. We do things on a daily basis in terms of adjusting the capacity, and we have the benefit of being able to interchange 757s. That's one of the reasons why we prefer the 757 and the 767 aircraft with a common flight deck where we can interchange pilots. A pilot can literally get off of a 767 and get on to a 757. We don't have any restrictions in that matter, and we'll adjust—It may not necessarily adjust block hours, but it will reduce some operating costs if we're able to downsize a 767 on a certain route to a 757 or consolidate two 757s into a 767.

But we do a very good job of matching the actual demand and the actual pounds that we're carrying to the actual hours that we're flying on any given night, but it's an ongoing process that will evolve over the year.

Kevin Chiang, CIBC

Okay. I'll leave it there. Thank you very much for taking my questions.

Operator

Thank you. The next question is from David Ocampo from Cormark Securities. Please go ahead, your line is now open.

David Ocampo, Cormark Securities

Thanks. Good morning, everyone. Jamie, I guess when we think about the domestic network and the ACMI business, and we've certainly seen a slowdown, but just curious how close are we to the minimum volume guarantees that you might have with some of your customers?

Jamie Porteous, Chief Strategy Officer

It's a good question, David. We're still well above those numbers. I think as we've indicated to you and to others before, about 75 percent to 80 percent of our capacity on the domestic network is made up of contract customers and their minimum volume guarantees. The balance is ad hoc customers that we have that we trade with on a daily basis, but also for peak and excess demand from our customers, which is—none of them are close to their minimums. I don't anticipate having that issue this year at all with any domestic contract customer. I think as we may have indicated before, in the history of our business, we've only come across that on the domestic once and it was during the peak of COVID where we had one customer who historically was only in the B2B space, has since evolved into both B2B and B2C, that was impacted and was below their minimums for a period of time, but that was back in 2020. I don't anticipate that happening with any customers this year.

David Ocampo. Cormark Securities

Got it, that makes a lot of sense. Then maybe next one is for Scott. I mean, last quarter you guys disclosed that you're deferring $320 million of CapEx and that number could increase to $400 million. Just curious if there's any update on this number or if you found more pockets of CapEx that you can defer or cancel.

Scott Calver, Chief Financial Officer

Really, at this time all that we've made plans for and committed to is that $110 million that you see on the assets held for disposal. It's still day-by-day, week-by-week as far as working with our customers and just seeing how the year shapes up to go any further than what we have optionality to do.

David Ocampo, Cormark Securities

Is there any recourse on the billed (phon) slots if you decide not to go through with it?

Scott Calver, Chief Financial Officer

It's a very small deposit and we've got a lot of time to—it's typically a year before the conversion, before you're up against that next milestone. But they're small deposits.

Ajay Virmani, President and Chief Executive Officer

We can extend the conversion dates as well.

David Ocampo, Cormark Securities

Okay, got it. Thanks a lot, guys. That's it for me.

Operator

Thank you. The next question is from Konark Gupta from Scotiabank. Please go ahead, your line is now open.

Joy, Scotiabank

This is Joy (phon) filling in for Konark. My first question is regarding CapEx. How do you see total CapEx trending over the next three quarters and in 2024?

Scott Calver, Chief Financial Officer

Good morning. So, if you go back to our guidance that we issued at our Investor Day last September and you look at the midrange for 2023, it was $350 million. Right now, that $350 million—we've got the $110 million for sale that's in our current assets, the assets held for sale, so that gets us down to $240 million. We could see it being as low as $200 million. It's going to be somewhere just around $200 million or north of $200 million. There's other delays that are out of our control, like the first 777. We thought originally at Investor Day that was going to come late this year. That's pushed out as much as six or seven months, or maybe longer, we don't know. So, probably close to that $200 million would be a fair number.

Joy, Scotiabank

Okay, great. I guess my second question is how soon can you guys add more aircraft to DHL this year, and what are your current expectations for ACMI revenue in 2024?

Jamie Porteous, Chief Strategy Officer

Good morning, Joy, it's Jamie. We'll continue with the 15 aircraft that we're operating for DHL today. As you may be aware, we're going to have—three of those aircraft we added to routes in 2022. As I indicated earlier, the total block hours may be less than what we were flying on average in 2022 because we had some long haul routes to Asia particularly that when demand softened, DHL redeployed those aircraft to other routes within their network. We plan to continue to operate those, and we're working closely with DHL to see what growth opportunities are for the balance of the year in terms of additional aircraft. It's one of the reasons why we've looked at freeing up some aircraft out of our domestic fleet, both on the 757 and the 767, but it remains to be seen. We're going to temper our growth expectations for the balance of the year.

Joy, Scotiabank

Okay, great. Thank you. That's all the questions for me.

Operator

Thank you. The next question is from Tim James from TD Securities. Please go ahead, your line is now open.

Tim James, TD Securities

Thanks very much, good morning. Maybe, Jamie, just returning to your comments on the DHL aircraft. Can you just walk us through for the remainder of this year, and I guess 2024, what incremental lanes or route responsibility you'll have with DHL? I believe Ajay mentioned earlier about some discussions around a couple of new ones coming this year. Can you just sort of indicate—you've said that you'll continue with 15 aircraft,

just sort of the moving parts as we look forward, what you'll be starting up with then?

Jamie Porteous, Chief Strategy Officer

As I said, we'll continue with the 15 routes, or the 15 aircraft that we're operating presently. We have two other routes to the Caribbean and Central America that are anticipated to start in the second quarter, sometime at the end of May or the end of June. Those are still yet to be determined whether they'll be long-term routes. We have the aircraft available. That would give us 17 aircraft, and we'll continue to look at other—certainly, there's a lot of ad hoc opportunities as well with DHL where there's specific demand on weekends or other times, other routes that they may want us to operate the aircraft. But other than peak season, the additional two routes starting this summer would be the only two that I would anticipate we'll see growth on this year.

Ajay Virmani, President and Chief Executive Officer

But those are ad hoc opportunities. We don't know whether they are permanent at this stage.

Jamie Porteous, Chief Strategy Officer

Correct.

Tim James, TD Securities

Okay, so we shouldn't think of those as part of that seven-year agreement and what you talked about in that this is incremental and, again, temporary to that whole agreement at the time.

Ajay Virmani, President and Chief Executive Officer

Yes. So, I mean, they are well within the committed seven-year plan. I don't know whether you want to consider—I mean, it's a total revenue plan and I think over the revenue, they're certainly on target on what they have committed, even with those.

Tim James, TD Securities

Okay, that's helpful. Any commentary you can provide, if we just really think kind of real time here, just even since quarter end in terms of volume trends that you're seeing in the domestic network in particular?

Jamie Porteous, Chief Strategy Officer

Yes. As I mentioned earlier, I think we're seeing sort of continued softening, and we're going into the summer months which traditionally the second quarter is sort of the softer quarter for us in terms of demand on the domestic network once we get into typically—second and third quarter, so the crossover between June, July and August. The flat year-over-year domestic revenue that we experienced in the first quarter, as I mentioned before, was a little bit below our initial expectations when we gave guidance—or not guidance, but gave our opinion back on the fourth quarter earnings call that we thought we would see low single-digit year-over-year growth. I think the fact that we're flat in the first quarter is an indication that we're going to continue to see flat or even a little bit of a continued reduction in demand, certainly in the second and the beginning of the third quarter, and that's why we're taking the initiative to drive block hours out of the domestic network to meet the capacity and the cost to meet the demand so we can protect our margins.

Tim James, TD Securities

Okay. If I could just one last question, I mean, that still seems—if you get slight declines given the economy and given all the dollars going to travel—I mean, I know the domestic competition is on the early days, but it still sounds to me like a fairly good result in this environment. I mean, I know it's not quite what you thought a quarter ago or several months ago but do you not still sort of feel that that's actually a good result against this backdrop?

Jamie Porteous, Chief Strategy Officer

No, we agree with you a hundred percent. We have a combination of the domestic contracts with the minimums that we have, the demand—the amount representing 90 percent of the domestic overnight business here in Canada, the service levels, our on-time—one positive thing that we didn't talk about during this earnings call is our on-time performance and reliability during the quarter on the domestic is probably the highest that it's ever been. That reliability and on-time performance is key for our customers to ensure that—everybody talks about competition, and yes, it's in the early days. WestJet and Air Canada not really in the domestic space. We're aware of that competition, but we're not really concerned about it. You're right, if you look at—we are happy with the results, and if we look at the details on our domestic

revenue, if we back out some one-time revenue that we had last year in the first quarter related to the domestic portion of revenue that we were able to generate to support some of the Asia flying that we were doing to fill the flights that were going over to Asia to come back on charters, we're actually up a little bit year-over-year when you back that out. So no, I agree with you.

Tim James, TD Securities

Okay, yes. Thank you very much.

Operator

Thank you. The next question is from Jonathan Lamers from Laurentian Bank Securities. Please go ahead, your line is now open.

Jonathan Lamers, Laurentian Bank Securities

Good morning, thank you for taking my question. Scott, you mentioned that if we had excluded three specific costs this quarter, gross margins would have been flat year-over-year. Could you just review what those three costs were? I guess in highlighting that, are you suggesting that margins could be flat year-over-year once certain costs have been taken out?

Scott Calver, Chief Financial Officer

Yes, absolutely. Good morning, Jonathan. If you look at our detailed disclosure on our direct expenses, what really jumps off the page is the crew and the depreciation. We've already talked about the depreciation, and Ajay went through the detail with the 757s, etc. On the crew, it's very early stages. It really started settling in at the beginning of March.

But long story short, if you went back and adjusted at historical levels for both crew and depreciation, that explains a lot of it in terms of the gross margin issue within Q1. But then what has a real significant impact is that $43 million in charter revenue last year in Q1. That was, like, once in a generation type of an event where you can get pricing to that. It was such extreme constrained capacity that that pricing is just very different than what we experienced in Q1 this year.

Those three things, when you get back to a normalized run rate, that reconciles that difference in gross margin year-over-year.

Jonathan Lamers, Laurentian Bank Securities

Could you just remind us when the flight simulator came online and sort of when you're expecting this training backlog to start to work down?

Ajay Virmani, President and Chief Executive Officer

Yes, so for the past, I would say, about six months, we've been using our own simulator in Hamilton, the first one. The second one is coming in October/November this year. It certainly helps not only training in-house, but also crew travel days and hotels and per diems. Also, just the overall training impact is much positive than sending people outside because keep in mind, when we hire pilots—we have 50 pilots right now in training. They're not part of any revenue generation. But that's the industry. So, once we have our own two simulators, then we don't need to send outside, and we can train them in-house more efficiently and more cost effectively. That would start probably in—we're slated to get it in end of quarter three, so probably sometime in the fourth quarter that will take over.

Jonathan Lamers, Laurentian Bank Securities

Thanks. Just one other follow-up question. On the 757s that have been earmarked for expanded leasing business, does that mean that there could be four to five domestic routes that might see reduced service as those are reallocated to support the leasing, or is the leasing purely an incremental opportunity kind of on weekends and where demand is low, etc?

Jamie Porteous, Chief Strategy Officer

It doesn't reduce service anywhere, Jonathan. As an example, if we put a—Ajay mentioned about a direct route that we were flying between Edmonton and Hamilton. We were able to consolidate that, free up two 757s by putting a 767 on that route. It doesn't have any impact on service, it's just matching the capacity to the demand.

Jonathan Lamers, Laurentian Bank Securities

Okay, thanks for your comments.

Operator

Thank you. The next question is from Walter Spracklin from RBC Capital Markets. Please go ahead, your line is now open.

Walter Spracklin, RBC Capital Markets

Thanks very much, Operator, and good morning. Ajay, I think you framed it right in your remarks that yes, we flag a downturn in revenue, we should be mindful of that but shouldn't lose sight of the longer-term systemic trends that capitalize on e-commerce and your strong competitive positioning. I like what I'm hearing in terms of during that downturn, you're aligning your costs to reflect the downturn but not losing sight of the revenue opportunity after that.

From a domestic perspective, I think that all makes sense. Where I think there's a little bit more misunderstanding is on the ACMI side, but I don't think the story's any different that yes, during a downturn, DHL is going to look to align its block hours and that's what they're doing. I'm wondering, I don't know if, Jamie, you can answer this the right way or not. But if you look at this downturn and what DHL is doing perhaps on a temporary basis, what level of quarterly run rate are we expecting here in 2023? Is what you delivered in Q1 kind of a run rate, or is that a seasonally low one? Just to understand where the run rate is while we're in this downturn. Then, on the upside, if DHL were to return to its, let's call it, pre-downturn activity levels, what is the more normalized ACMI revenue run rate that you have with the aircraft that you are dedicating to them now and will be longer term?

Jamie Porteous, Chief Strategy Officer

Good morning, Walter. I think the Q1 run rate for ACMI would sort of be reflective of what we—at the low end of what we see for the balance of the year. The couple of routes that I indicated earlier that we're starting to the Caribbean and South America at some point in the second quarter, as Ajay mentioned, may only be temporary. If they end up being longer term to the end of the year, then certainly that'll be incremental growth going out for the balance of the year. With the exception of peak season because I would expect that our demand in peak season from DHL and our other ACMI customers will be stronger in that quarter versus the previous year. But I think using Q1 is somewhat reflective of what we see as the sort of bottom line for ACMI revenues going forward.

Then, to answer your question, one of the reasons why we have the fleet that we have, and you're absolutely right, in keeping the—even though we made some decisions on the longer-term growth with the 777 aircraft but keeping those slots and keeping the first aircraft that we have commitments from DHL for in 2024 and 2025 is to be able to pivot our business very quickly to meet that demand. As we've indicated and as we've experienced over the last few years, one of the reasons we benefit from the relationship and the growth that we've had with DHL over the last few years was because of our ability to pivot very quickly in the early days of COVID to provide dedicated cargo capacity for them, and that's translated into the long-term operating agreement that we have with them today.

Walter Spracklin, RBC Capital Markets

Putting that into numbers, I mean given the current run rate that you mentioned of Q1 plus, plus in Q2, Q3 and then obviously reflective for Q4, that's in the, let's say, $65 million to $70 million range in the first part of this year. Is that $65 million to $70 million, when we look at our numbers on a more normalized full run rate quarterly in the first three quarters of the year, could be more in the $80 million range if you were to be fully utilizing those aircraft in the first three quarters of a more normalized year. Is that off the mark, that $80 million run rate if we do see a rebound in overall demand?

Ajay Virmani, President and Chief Executive Officer

Well, when things rebound, anything is possible, right? But I mean, we've had some ad hoc discussions with DHL and a couple of other ACMI opportunities. Everybody is looking at quarter four probably this year a little bit of a turnaround, and I think we'd be the first one to get calls. This is why we are kind of afraid to—we're a little bit hesitant to go out and sell these 757s. That's why we have put it up for short-term lease opportunities at this time. I think that the minute things open up we can plug the 757s back in and free up the 767s for those opportunities. The flexibility has to be maintained, Walter, because we cannot (inaudible). We cannot go find planes when opportunities arise.

On the other hand, we can't wait forever for those opportunities as well, so that's why monitoring the trends and staying close to the customers and finding out what we should hold. The cost reduction is temporary help right now, but I think some of the assets—I mean, we could easily sell the 757s tomorrow close to $100 million. But we also have to look at the flexibility that it's giving us to interchange between 75 and 76 domestically according as the demand changes and also watching for if things don't improve by quarter three or quarter four, then all bets are off on anything. But I think it will not be wise for

us to dispose of any of these assets reacting to the short-term market volatility right now.

Walter Spracklin, RBC Capital Markets

That makes sense. Thank you, Ajay. Then, just last for me, back to you, Scott, in terms of CapEx. I hear you on the $200 million, roughly just north of $200 million for 2023. You did mention, though, that that would be reflecting also a shift of a 777 delivery into 2024. Just want to make sure so that expectations are aligned appropriately now, that will bump up your 2024 CapEx, having that delivery early in the year. What are you framing for CapEx for 2024, just to frame it or to position the expectations properly?

Scott Calver, Chief Financial Officer

Walter, I think you're bang on there in terms of what we—those ranges that we provided for our disclosure, for our guidance for the whole strategic plan, the guidance that we provided last fall, it's still consistent. We're not changing that. So yes, there is going to be some movement out of 2023 into 2024, but that 777 and some related costs that relate to that, that would be the main thing right now.

Walter Spracklin, RBC Capital Markets

Okay, that's all my questions. Thanks very much, guys.

Operator

Thank you. The next question is from Steve Hansen from Raymond James. Please go ahead, your line is now open.

Steven Hansen, Raymond James

Yes, good morning. Thank you for the time. Commend you for taking swift action here to right size the costs, and I do recognize the balance you're trying to strike between cost and service. But in the event that demand was to deteriorate meaningfully further, say another 10 percent or more, how would your plan change today, or would it just be at a more rapid pace that you would expect, or what would you do differently in the event that demand does continue to break down here? Thanks.

Ajay Virmani, President and Chief Executive Officer

Well, look, I mean, we replaced two 757s with a 767, which took out, like on a particular plane, a 25,000 pound, 30,000 pound reduction, which is 25 percent space reduction from what we had planned for the quarter one. If demand was to go down further, we take 767 out at 120,000 pound (inaudible) and replace it with an 80,000-pound aircraft. We do have the fleet flexibility today we are enjoying, that if the aircraft are not flying, I mean, sitting here we already have the capital expense. It's not going to cost us any more money, except the depreciation portion of it. But our main cost driver, as I said, is block hours and the type of plane we fly on a certain route. So, if the demand was to go down 10 percent or 15 percent, the easiest thing for us is to adjust the size of the aircraft and reduce sometime the frequency of it or something. But that would be the major thing we would do immediately. That is being monitored, by the way, not on a weekly basis or a monthly basis, it's done on a nightly basis with our network planning folks that they know what's coming in by 6:00, 7:00 at night and we plan that right kind of aircraft in that market. So, it's an ongoing process.

Steve Hansen, Raymond James

Appreciate the colour, thanks.

Operator

Thank you. There are no further questions registered at this time.

Ajay Virmani, President and Chief Executive Officer

Thank you, everybody, for joining in the quarter one conference call. We'll continue to work hard to weather the storms in this economic environment. Thank you very much, everybody.

Operator

Thank you. The conference has now ended. Please disconnect your lines at this time and we thank you for your participation.