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PRESENTATION

Operator

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

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

Pauline Dhillon, Chief Corporate Officer, Cargojet Canada Ltd.

Thank you, Operator. Good morning, everyone, and thank you for joining us on the call today.

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 Vice President of 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 this call, such as those relating to our forecasted revenues, costs and strategic plans, are forward-looking within the meaning of applicable securities laws. This call 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 reconciliations of non-GAAP measures to GAAP income.

I'll now turn over the call to Ajay.

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

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

I want to begin by sharing a few thoughts on the economic climate. Although the central bank started to raise interest rates last March, the impact on consumer behavior is just beginning to be felt. We saw this in our December peak period, which was slower than last year. We expect the consumer will remain cautious and retail sales to remain subdued in the near future.

However, I want to put Cargojet's last three years in context. Our Adjusted EBITDA for the year ending 2019 was $156 million, and we ended '22 with EBITDA of $330 million. This is an increase of 111 percent over three years. There is a perception that all of the growth was COVID-driven. Let me remind you that these three years, we have brought in a major strategic partner, DHL, and diversified our business into ACMI as a strong pillar. This new revenue improves the mix between our flagship domestic business versus the lines of business charter, although cyclical continues to be an important and opportunistic business that helps us utilize our assets when they are not supporting our domestic overnight network.

We are also being prudent in managing cash flow and capital expenditures. Given the nature of our business, we have always structured our capital expenditures and their plans with flexibility and optionality. With the changing economic conditions at the present time, we are exercising that very flexibility by deferring capital expenditures previously announced by approximately $400 million. This will involve—the major portion of this will involve not two but four 777s, we will have a reduction of four 777s from the eight. Scott will have further comments on this particular matter.

I also want to highlight that while we have done that, we have maintained our flexibility with MROs for conversion slots which are premium, and we will hold onto that and defer them by 12 months to 18 months, or two years if we need to, to see the economic climate—what kind of conversions it would warrant. Scott will provide more colour on this, as I mentioned.

As an entrepreneurial company, we have always been focused on cost management. As the pandemic hit, we were focused on meeting the demand and deployed resources and added costs to successfully manage the opportunity. At that time, our simple principle was we need to handle the volume which was overflowing, and it had to be done at any cost. Now we find ourselves dealing with a different set of economic environment and have shifted back to our basic routine of focusing on every dollar we spend. Every dollar we're spending is under review; as such, we have several initiatives underway that will reduce costs and allow us to remain focused on our goal of maintaining historical margins.

We are also focused on the right-sizing of our network, our fleet, and our human resources to match the demand out there. At a macro level, ecommerce has now become part of normal consumer behavior. A lot more essential goods are being ordered online versus selective buying that occurred prior to COVID. The job market continues to be resilient and inflation is starting to show some signs of weakening.

It's also worth noting that our business is underwritten by some of the world's largest logistics brands, such as Purolator, Canada Post, UPS, Amazon, DHL, TFI International, and (inaudible) Health Group. There's an old saying: you're as good as the company you keep. These are resilient businesses and will continue to be the backbone of our global trade and commerce.

In the fourth quarter, we announced the renewal of UPS contract in mid-January. We announced the Canada Post and Purolator contract extensions in January as well. These contracts are long term. They were expiring in March 2025, but having heard of our investment partners, we purposely extended these contracts through 2029 and 2031, locking up these customers and ensuring that there's no competitive impact on our business. This also solidifies Cargojet's leadership position in the Canadian overnight air cargo market. We have now extended all our strategic customers.

We have managed two down cycles before when Cargojet was a much smaller organization with limited options to manage costs. Today Cargojet is much larger with much more optionality in managing the economic cycle. You may recall we started to prepare for the cycle back in January 2021 when we solidified our liquidity and our balance sheet by raising $365 million of equity. We remain confident in our long term growth strategy and expect to resume our capital expenditures on growth initiatives as we come out the economic cycle.

Just as our team demonstrated resilience in managing rapid growth driven by the pandemic, we are equally capable of managing the down cycle with similar rigor and discipline. One of the biggest lessons we have always learned in our business is it's never as rosy as it seems and it's never as gloomy as it appears, therefore we will stay focused on our long term mission of creating shareholder value and managing our short term volatility.

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

Scott Calver, Chief Financial Officer, Cargojet Canada Ltd.

Thank you Ajay, and good morning everyone. I will focus my remarks today on three topics: first, our results.

Cargojet posted yet another strong quarter with a 13.2 percent increase in our revenue. Our diversification strategy is paying dividends, as demonstrated by the strong growth in our ACMI business while our domestic business started to see some weakness late in the fourth quarter. The softer margins in Q4 compared to last year reflect our deliberate decision to not disrupt peak operations that are crucial for our customers. There are a number of pandemic-era extra costs that need to come out of the business, and we have embarked on a careful plan to streamline all cost line items across the business.

Towards the end of November and throughout December, Cargojet and our customers experienced volumes that were lower than anticipated. The recently released economic data clearly shows a decline in consumer spending as the month of December progressed. After consultation with our strategic customers, the consensus was to consider the December slowdown as the beginning of a trend, a trend that ultimately could be a recession with reduced customer spending.

In December, Management pivoted to a disciplined focus on cost management per block hour and to further strengthen our balance sheet, which brings me to my second topic, our balance sheet. We are paying equally strong attention to keeping a strong balance sheet and we have made several decisions to temporarily bring down our overall Capex spend by $320 million to $400 million, as Ajay mentioned, compared to what we shared with you at our investor day last September.

As part of our previously stated diversification and growth strategy, Cargojet undertook to add Boeing 777 long range fuel efficient aircraft to our fleet to expand international reach, strategically enhance our domestic network, and to broaden capability for long range charters. This aircraft allows Cargojet to selectively add international routes that synergistically connect with our flagship domestic network.

A total fleet of eight 777s were planned with the first four 777s to be deployed with DHL as part of Cargojet's strategic agreement, and with the remaining four to expand our international reach. The four aircraft embarked for DHL will continue conversion, but recent forecasts for the slowing global economy will curtail our capital expenditure and defer taking delivery of the final four 777 freighters, as previously announced, while maintaining full access to our conversion delivery slots.

Arrangements with our MRO partners give us flexibility to maintain access to these valuable wide body aircraft conversion slots while at the same time better timing our capital commitments considering the global recessionary risk. The feedstock market for 777s is expected to remain strong, allowing Cargojet to initially divest feedstock of two 777s, freeing up cash to be used to pay down debt while retaining optionality on conversion slots for the 2024 through 2026, should the economic climate turn positive earlier than expected.

To summarize, the first four 777s for DHL are still planned. The four that are designated for general growth, we did not buy feedstock for the fifth unit, that's deferred, the sixth and seventh units are relate to the LOI, as previously noted, and the eighth unit will be deferred, as previously discussed on the last results call, and this feedstock may be sold as well.

The impact of the $320 million to $400 million deferral to our 2023 growth Capex spend will be a net reduction of approximately $100 million to $125 million, and it could be slightly higher if we sell that last feedstock. The remainder of this deferral will impact mostly 2024, if required.

The third topic, the resilience of our business model. As Ajay mentioned, in mid-January we announced the Canada Post and Purolator contract extension. This contract was to expire March 2025. The agreement was extended to September 30, 2029 with an option to extend to September 30, 2031. This early extension solidifies Cargojet's leadership position in the Canadian overnight market. We have now extended the contracts for all of our strategic customers. These contracts were extended well before their contractual termination dates and they extend out to 2027 and beyond. These are solid examples of our value proposition.

During peak COVID, the demand of air cargo led to Canadian passenger airlines entering the air cargo market with the launch of their own dedicated freighters. As demonstrated with our 100 percent customer retention rate, our business model has once again passed the competitive stress test of our customers evaluating their options and renewing long term contracts with Cargojet. All domestic and ACMI contracts contain minimum volume guarantees. These provide further support to Cargojet during softer economic cycles.

In conclusion, we have rapidly responded to manage the business during this down cycle. We have taken rapid steps to preserve margins, profitability, and to maintain a strong balance sheet. We have a strong team that can execute our cost control initiatives and we look forward to updating you on our progress in coming quarters.

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 Konark Gupta from Scotiabank. Please go ahead, your line is now open.

Konark Gupta, Scotiabank

Thank you Operator. Good morning everyone.

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

Good morning.

Konark Gupta, Scotiabank

Good morning Ajay.

My first question is on the ACMI. Given the DHL ramp-up that's been going on, what was primarily the driver for the revenue decline in Q4 versus Q3 sequentially, and would you expect this Q4 ACMI revenue run rate to continue in 2023 or should it increase the new aircraft offset by maybe block hours going down?

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

I'll get Jamie to answer that.

Jamie Porteous, Chief Strategy Officer, Cargojet Canada Ltd.

Yes, good morning Konark, good morning everybody.

I mean, part of the reason we saw a reduction in ACMI flying in Q3 was just the redeployment of—a reaction by DHL globally from the softness that we saw here domestically and globally rearrange some flying. As an example, for most of the year we were flying two aircraft on routes from Cincinnati to Vancouver to Shanghai, and when there was softness in that market in the fourth quarter, those aircraft were redeployed to new routes in Central and South America, and that reduction in block hours is still well above the minimum number of block hours per month but lower than what it would have been comparatively to previous quarter.

In terms of 2023, we'll continue to see strong growth on the overall ACMI business in '23, a combination of the result of the annualized benefit of the three routes that we—three routes that we started at different points in 2022 for DHL, that you'll see the full annualized effect in this coming year.

Konark Gupta, Scotiabank

Okay, that's great colour. Thanks Jamie.

Then with respect to the fleet, I probably missed the Capex number if you guys laid it out on the call here. The prior guidance I remember on Capex for 2023 was $320 million to $370 million. With the fleet changes you announced this morning, which included, I think, two 777 sales as well as, I think, deferral of some slots for conversion, where does the Capex go from that guidance for 2023?

Scott Calver, Chief Financial Officer, Cargojet Canada Ltd.

Yes, it's Scott here, I'll take that one.

It's going to reduce by—in a range of $100 million to $125 million. Now as Ajay mentioned, we do have optionality to sell that feedstock for that eighth 777, it could even be expanded off that range, but currently right now, we're planning in that range of $100 million to $125 million reduction from what was previously disclosed.

Konark Gupta, Scotiabank

Okay, that's good. Thanks Scott.

Is that—just to confirm, that $100 million to $125 million reduction, it includes as well the two 777 sale proceeds?

Scott Calver, Chief Financial Officer, Cargojet Canada Ltd.

That's right, absolutely.

Konark Gupta, Scotiabank

Okay, thank you.

Then last one from me, with the kind of macro environment that you guys are seeing here, and clearly you called out the peak season being softer than expected could be a trend, with the ACMI growing in '23, domestic may be softer than maybe initially thought. Would you still expect 2023 to be a growth year from both a revenue and EBITDA standpoint, given the commentary in the MD&A that the margins are likely to be stable?

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

Konark, yes, we expect the 2023 to be a growth year, but certainly not a double-digit growth year. We expect that it will continue to grow—that's what our customers are telling us, but it won't be like the hockey stick that we have seen in the past three years for sure, so it will be in the mid single digits, probably. That's what we're looking at on that.

On the 777s, I also want to clarify that, just to make it clear, that we had originally bought four 777s for non-DHL purposes, and out of those we cancelled one agreement, then we have three feedstocks. Already two have been sold out of that, one is in the process of selling. We would—that's where the major reduction of almost $400 million is going to come, from 777s and related costs. But when we say we are cancelling it, we are cancelling buying the feedstock or selling it, but we are maintaining the conversion slots, we are still in the market should things improve.

Konark Gupta, Scotiabank

Okay, thanks for the colour. I appreciate it.

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

Yes, good morning. Thanks very much.

Maybe just to go back on the Capex question, you gave some good details around 2023. Just wondering if you've got kind of a new expectation—obviously there's some moving parts here, but just wondering if you have a new expectation for 2024 Capex.

Scott Calver, Chief Financial Officer, Cargojet Canada Ltd.

Okay, maybe if I just back up a little bit, because we'll just anchor with what we've previously disclosed last year, where it was going to be approximately $1.1 billion. When you see our Q4 results and what we spent in 2022, we spent just over $600 million, and about $480 million of that was growth capital, we've already spent $480 million of $1.1 billion in growth capital.

When you look at the deferral that we announced, and as Ajay said, it could be as high as $400 million, most of that will impact the 2024. Now, we don't know if it's a six-month deferral, 12-month deferral, or an 18-month deferral. We're just really as nimble as possible here to have all optionality, that if this recession doesn't happen or it starts to turn in Q3 of this year, we're going to pivot right back to growth, like what we demonstrated in 2020, 2021 and 2022.

To answer your question, about $100 million to $125 million in 2023 with the remainder mostly being in 2024, and again there is that optionality to expand from that 320 to 400, and a lot of that could impact this current year as well if we sell that last feedstock for that 777.

Cameron Doerksen, National Bank Financial

Okay, that's clear.

Scott, maybe another question for you, just to—obviously you guys had, I guess what you would call excess costs in 2022, a lot of which are not going to repeat in 2023. Can you just maybe talk through, I guess some of the details there as to what you expect to see from a total cost, sort of reduction based on some of the, I don't want to call them one-time costs, but I guess excess costs that aren't going to recur, that happened in 2022.

Scott Calver, Chief Financial Officer, Cargojet Canada Ltd.

Yes, absolutely. With 2022 being a record year for year-over-year growth, we just couldn't grow fast enough to service our customers they way they wanted to be serviced. When you can't grow fast enough, you do everything pretty much at any cost.

Now, that's overstating it, but we ran very high costs for overtime and for training, and to some extent for temporary employees, and when you look at training, it's kind of a double whammy here because the training was very, very expensive. If you remember, earlier in the pandemic the training was very minimal because we were hiring pilots that were already certified to fly 757s or 767s because they were laid off from passenger airlines, so that was a very different dynamic than what we experienced last year.

We went from being able to train pilots measured in days to training pilots measured in months, and when you're taking several months to train a pilot to be certified to fly a 767 or a 757, in the meantime you're running overtime to backfill for those positions, We ran very, very high cost to on-board all that revenue growth last year.

As we noted, we started to make plans in December. They settled into place in January and to a larger extent in February to deal with those three things: overtime, training, and temporary employees, and there were other things as well.

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

I must add that when we saw the slowness, it wasn't in October and November as much as in December, and we already had built schedules, network and everything getting ready for December, and we did not see the volumes that we normally see in December, so the first signs of slowness were literally in December, and whereas the cost structure, the network was all built up. It's very difficult to change everything on a day-to-day basis because you expect that, okay, the volumes don't show up on December 5 but they might show up on the 6th or 7th, you can't take the costs down that quickly.

But on top of the cost that Scott is talking about, we are also now right-sizing the network. Keep in mind, we do have fairly good flexibility to switch between 767s if we need to consolidate more cargo and also split certain routes into 757s for more operational efficiency. That exercise is ongoing right now and we expect that within the first quarter, we'll make tremendous adjustments in our costs, training over time, right-sizing the fleet, and basically freezing everything else that does not produce at all.

Cameron Doerksen, National Bank Financial

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

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.

Scott, maybe a quick clarification just to kick things off. On the margin commentary, that it should hold flat, are you expecting margins to hold flat with the Q4 or the overall margin level that you guys experienced in '22?

Scott Calver, Chief Financial Officer, Cargojet Canada Ltd.

Yes, getting back to the 2022, just our historical type of EBITDA margin in that 30% to 34%, 35%.

David Ocampo, Cormark Securities

Got it.

You guys provided some pretty good commentary on the Capex assumptions there. What's the financial impact to the EBITDA line, because you guys did provide—or previously provided 2026 targets on EBITDA?

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

We will push those out, right Scott?

Scott Calver, Chief Financial Officer, Cargojet Canada Ltd.

Yes, it's a deferral, and we don't—again, we're just going to be able to pivot in either direction quickly. We don't know if it's a six-month, 12-month or 18-month deferral, but we're going to—really, you're pushing those things out, I would say on average of about a year. If you look back to that long-term plan, 2026 was a pretty light year for Capex anyways, so it's almost just shifting '24 to '25, '25 to '26, just for round shifting. But we're still very, very committed to—we just can't emphasize enough what Ajay was talking about there, that we're retaining our conversion slots. That's what's most critical to this business, is that we can get the feedstock quickly but we've still got our conversion slots so that we can go ahead as planned.

David Ocampo, Cormark Securities

Right, I guess your assumption is that you could still hit that $500 million to $550 million of EBITDA but it may not be '26, but '27 or '28?

Scott Calver, Chief Financial Officer, Cargojet Canada Ltd.

Yes, we didn't know there was going to be a global recession last summer and last September when we had that Investor Day, otherwise we probably would have been less bullish on the 2023.

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

But our key thing was that we still believe in a good business case for us expanding, but only if the market sort of creates that opportunity. If it's not, even when we built the business plan about a year ago, we knew that if there is an issue, we can get rid of some of these costs and airplanes very, very quickly, and which we did while maintaining that we are in the game but we don't have the costs associated with being in the game.

David Ocampo, Cormark Securities

Got it.

Then maybe just as a final one, when you think about your infrastructure investments for the 777s, like new hangars and whatever other infrastructure related investments you have to make, with the deferral of the 777s, can you still hit your return on invested capital targets with less scale?

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

We will have some deferrals on hangars that we wanted to build, and tooling and training, that's all been deferred. Also keep in mind that one of the things we are looking at is if we do build the hangar for 777, it will be able to take two 767s also. Those hangars would be very useful to us no matter which part of the country we build in, whether we build in Vancouver, whether we build in Hamilton or whether we build in Halifax.

Those hangars can take 777s and if—let's say for example we don't need it for 777s, then we can put 767s in it for our heavy checks. Those would not go to waste. Hangars is a good—we are short of hangars now even for our 767s, most likely the hangars will go ahead but it's not going to be just a 777 hangar, it's going to be a hangar for—keep in mind, we're operating almost 40 aircraft now, we only have two hangars in Hamilton, we could use two hangars somewhere else.

David Ocampo, Cormark Securities

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

Operator

Thank you.

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

Scott Calver, Chief Financial Officer, Cargojet Canada Ltd.

Morning Kevin.

Kevin Chiang, CIBC Capital Markets

Good morning everybody, and thank you for taking my question.

Maybe to start off with, a lot of good details on some of the moving parts on the employee expense line. You talked about the OT, the training and the use of temporary employees. But if I could—if I look at maybe just crew costs as a percentage of revenue extra charge, you're tracking around 12, 12-plus percent in 2022. You were sub-10 percent in 2019. Do you see an opportunity to throttle that line item to maybe back to what you saw in 2019 from an intensity perspective, or is that cost just structurally higher here as a percentage of revenue, just given the growth profile of the Company over the past couple of years here?

Scott Calver, Chief Financial Officer, Cargojet Canada Ltd.

Yes, thanks Kevin.

That's exactly what we did during planning season, is we benchmarked back to 2019 because that's when we were—our primary focus was cost controls, and just before that massive growth where we doubled the size of the Company in a short period of time. Yes, that's exactly the plan here.

Obviously there's been some inflation since then, but with critical mass with the size, with the new simulator in Hamilton to reduce training, all this stuff is going to get us back to our roots where we've always said it, I think on every call I've been on with Jamie, he talks about how we manage our cost per block hour, we manage everything to the minute. That's exactly what we're describing here, is really getting back to our roots and what we demonstrated in all those years leading up to 2019.

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

Kevin, let me add something more to it, that one thing that changed in 2020 was the duty regulations by Transport Canada. That part of it, we won't be able to overcome because that's what the government is and the duty regulations are. However, we have our own sim now which saves us travel days, training outside, hotels, airfares, all that. We are trying to find how do we make up for those extra costs for the duty regs, and we are constantly focused on that. Our training costs will come down, our other costs will come down, and we want to get closer to the 2019 levels, but one thing that we will not be able to do is there will be some costs that we won't be able to cut, which is the new duty regulations, but we are trying to offset with other types of savings.

Kevin Chiang, CIBC Capital Markets

That's a great reminder and great additional colour.

Maybe just more of a housekeeping question, again just on the employee expense line, or the employee line, the headcount number was up pretty significantly sequentially from Q4 versus Q3. When you report that headcount number, would that include temporary employees, some of that variable labour you might be able to pull on, or is that just full-time employees, and if it is the former, are you able to quantify how many temporary employees you would have used during peak season of Q4 of 2022?

Scott Calver, Chief Financial Officer, Cargojet Canada Ltd.

Yes, that excludes our temporary employees, but what you saw there was some flexing up for peak with part-time employees. There is a little bit of noise there in terms of they're not exactly a full-time equivalent.

Kevin Chiang, CIBC Capital Markets

Okay, that's helpful. That's it for me. Thank you very much.

Operator

Thank you.

Our next question is from Chris Murray from ATB Capital Markets. Please go ahead, your line is open.

Chris Murray, ATB Capital Markets

Yes, thanks folks.

Maybe turning back to some of the newer contract wins with Canada Post, if we go back a couple calls, we had talked a little bit about maybe having to (inaudible). Can you walk us through how the structure of those contracts look and if there were any major changes from how they were designed the last time you signed them?

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

Some of that information, Chris, you can appreciate is confidential. We are bound by the confidentiality with the customer and we also don't want to get into too much contract stuff, especially with a lot of competitors trying to get into the business, which is kind of tough because we have them locked up, but we don't like to release a lot of confidential information.

But the contracts were done seven years, eight years ago. The market has changed a lot. Our financial profile has changed somewhat as well, and I think we want our customers to grow. One thing I can tell you is that there are enough growth incentives for the customers to take advantage of the unused space and grow in those areas. That would be the basic difference that I'm able to tell you or share with you, is that we have created some value-added features to our customer contracts that some of the growth could be at a lesser of a price for them to go sell areas that they normally don't look at.

For example, I'll give you—there might not be stuff being sold from Winnipeg to Vancouver, for example, so they'd never looked at it is—they would always be selling Hamilton to Vancouver. We have said, look, we have some space from there and why don't you go look in the market and see if you can get more business.

You might say, okay, are you getting a discount at growth? Yes, we're getting a discount at growth but that's coming in areas that are not being used, overall it will be net positive. Those are some of the things that we have offered our customers, some incentives to go out and develop more business on areas that we could use as fillers (inaudible).

Chris Murray, ATB Capital Markets

Okay, that's helpful.

Then just thinking about the fleet, if I kind of compare the Q3 fleet plan to Q4, the number of 757s seems to have stepped up a little bit more. I think you've got four additional aircraft coming early in '23. Can you talk a little bit about your ability to use the 757 in the domestic market and your ability to use that aircraft to flex down if you need to, so if we do get some softness. Would the 67s in the domestic market then, would they just turn into maintenance spares or is the plan still to find something profitable to do with those, even in this climate?

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

Chris, one of the things we never had the luxury in the past three years to have maintenance spares, operational spares, hot spares as our customers have asked, because there were no aircraft available up to 2022. The 757 and the 767 gives us flexibility now to have a spare of each kind to maintain our service levels. Also, it also gives us a maintenance spare for when the planes go into (inaudible), but also the flexibility of monitoring our network on a daily basis almost that if you only have 80,000 pounds going to one station, we can put the 757 on and save a lot of operating cost rather than putting a 767 on.

Similarly, if the volumes are more one day, we can switch it to a 767, so a combination of that strategy will help our overall cost structure to be better, but also keep in mind that with the growth we saw in the past couple of years, especially—even in the domestic market, we were very focused on in terms of having the right number of aircraft flying for our network and leaving us 757s and 767s for charter work. There is a lot of opportunity for those. Yes, we did buy some extra 757s, but most of them are doing the network or acting as spares.

Our domestic fleet is fully pretty well deployed except two 767s, which we feel—one of them is being leased now by our partner in the U.S., 21Air, because they needed that aircraft, so we had the flexibility to place one of our 767 300s there. I think we are also in discussions with many other clients to place the next one. There is a couple of spare aircraft that we have more than what we need, but we are confident that those particular aircraft will be placed in the next coming months.

Chris Murray, ATB Capital Markets

Okay, that's helpful. Thank you.

Operator

Thank you.

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

James McGarrigle, RBC Capital Markets

Hi everyone, and good morning. This is James McGarrigle (phon), I'm on for Walter this morning.

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

Okay, good morning James.

James McGarrigle, RBC Capital Markets

Good morning.

I just have a quick housekeeping question to start on the fleet expansion. I know you've spoken to the 777s earlier on the call, but I just want to clarify that right now, the only planes that are not contracted with DHL are three 767s and that you have the option to cancel two of those. Do I have that correct?

Scott Calver, Chief Financial Officer, Cargojet Canada Ltd.

Yes.

James McGarrigle, RBC Capital Markets

Perfect, perfect.

My other question was on DHL. I know they announced an increase to the South American investment and that Cargojet got a new route from that as well, so congrats on that. It seems like DHL is investing heavily for future growth despite some immediate term volume headwinds. Is this kind of consistent with what you're seeing from your other large customers and how are they talking to you about their capacity needs longer term, and are they still bullish on the ecommerce outlook into '24 and '25, just given some of the recent headwinds we're seeing?

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

Let's take the ecommerce element first. Yes, the ecommerce people are bullish, but as I had mentioned in the call earlier, they're not bullish with a hockey stick growth, they're more looking at anywhere between 5% and 10% type of growth going forward. That's what our customers tell us, that's number one.

Number two, with DHL investing in spite of all the rhetoric out there about a recession and everything, let me say this to you. DHL or any international carrier, whether it's UPS, FedEx, their business—and again, I don't get into the business. From what I can see and what I can tell and what I've been told is the biggest issue or driver for them has been the China business. If everybody is down 37 percent to 44 percent on the China lane because of China's no COVID policy, the factories were closed, the trade relationships have been bad. That has been the major problem for all companies like DHL, is the China business.

Europe remains strong, Mexico and South America remain strong, and if China does not improve, obviously it's a problem globally that everybody would face. I'm sure you have seen articles come out in various publications about empty ships and empty planes out of China. That is the major problem, one area is dragging pretty well the whole world on shipping.

Now the good part is that a lot of companies are now shifting focus from China and going to, for example, India. The iPhones are being made in India now, glove business is moving from China to Vietnam, robes are being made in Thailand now. There is a lot of shift of industrial stuff that was made in China to reduce the dependence on China to other countries.

When these things start functioning well, it will take some time to adjust, but it will settle down. China will maintain some, but they would certainly lose some shipping to other countries. That is the major culprit in this whole exercise as far as the shipping is concerned. It's not a global phenomenon. Yes, people bought less in December on ecommerce, because people were too busy spending their disposable income on travel because that's where you saw the big money was being spent, or restaurants or resorts, because people were locked up for three years. People were stocked up for three years and locked up for three years. That's why we saw the decline in December.

Our customers still feel that as for the ecommerce side of it, it will come back up. As for the ACMI side of trade is concerned, yes, until the China things improve, it will be a bit slower, but as I said, alternate markets are coming up and they will be shipping, if not from China, from somewhere else.

James McGarrigle, RBC Capital Markets

I appreciate the colour, and I'll turn the line over. Thank you.

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

Thanks James.

Operator

Thank you.

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

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

Morning Tim.

Tim James, TD Securities

Good morning everyone. Thank you very much for the time.

My first question, I just want to look at the return on invested capital. I'm wondering if you can talk about how you see that trending in 2023 and then maybe in the two or three-year period beyond that, relative to what you reported for the full year 2022.

Sanjeev Maini, Vice President, Finance, Cargojet Canada Ltd.

Tim, Sanjeev here.

We still expect that in 2023, it will be in the teens, low teens to mid teens range, and we expect that as our ACMI business will grow, our returns should grow along with it. But it all depends on the economic environment, when that growth will happen, but we will be able to maintain this return on invested capital, what we have reported in the current quarter, between 13 percent to 16 percent.

Tim James, TD Securities

Okay, thank you.

My second question, thinking about the market environment going forward over the next couple of years, should we kind of view the general global environment when thinking about how likely you would be to use those conversion slots that you've maintained, or could there be sort of unique opportunities that maybe go against the general headwinds that we see in the global air cargo market, that maybe provide you with what you need to say, hey, let's go ahead and take up and use those conversion slots?

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

Let me put it to you like this, those conversion slots can also be sold, transferred and deferred. We're not married to saying that we are going to use them. We'll use them only as we've always done. In this case, we had eight of them coming, 777s, and four were sort of committed and four were for our growth. Being sort of on the cautious side and maintaining flexibility, we were able to sell the four and maintain the slots. If we find that the market is not maturing, there's enough people lined up to get conversion slots, because we have the early '24, '25 conversion slots. There's quite a bit of demand for those conversion slots. We would be happy to either sell them if the market didn't mature, or we could convert the plane and sell the plane or try to lease the plane or fly commercially, or do an ACMI; there's a lot of options.

I think what we have seen in this market is if I had these 777s in the COVID environment in 2021, '22, we would be looking at $500 million of EBITDA today. In our organization, we don't want to lose the flexibility of ramping up with the very little cost associated with it, and that's the model we have created.

Tim James, TD Securities

Okay, that's helpful.

Then my final question, you've provided some good pieces of information on the DHL business and the opportunities there. I'm wondering if you can sort of reflect on their behavior, like in terms of routes and capacity and the supplier group that they have, anything you've learned now that we've seen kind of a turn or a weakening in demand, has their use of your fleet, of your capabilities kind of aligned with what you anticipated? Have you sort of learned anything, or any general observations you could provide to us there?

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

Jamie, you want to take that?

Jamie Porteous, Chief Strategy Officer, Cargojet Canada Ltd.

Yes, thanks Tim.

Yes, I think it's been exactly what we've been articulating for the last couple of years. Obviously our relationship, we have an operating agreement, a five-year operating agreement with DHL which his unique. Nobody else has that type of ACMI agreement in the world. We obviously are the, if not number one or number two in terms of on-time performance and reliability, which has enabled DHL to enhance its service level to its customers around the world, and of course we have a financial agreement with a warrant deal that we have. There's an incentive for them to reach certain revenue milestones, and we've seen exactly what we had been articulating for the last couple of years.

There were some changes in the ACMI DHL flying in 2022 that I alluded to earlier, where we switched some routes, or they switched some routes that were operating for most of the year out of North America into Shanghai, China. When that demand dried up, those routes were switched and we kept the aircraft on other routes into Central and South America, and in actuality one of the routes we actually replaced was an American carrier that was flying there. That was what we anticipated and had articulated to the market that we would expect, and it's what we would continue to expect in 2023 and 2024 as we go forward.

Tim James, TD Securities

Great, thank you very much, Jamie.

Operator

Thank you.

The next question is from Steven Enson from Raymond James. Please go ahead, your line is now open.

Steven Enson, Raymond James

Yes, good morning everyone. Thank you for the time.

I'm going to stay on the macro theme that Tim was touching on here a moment ago. I think as you suggested, the mainline carriers have been bringing on their own dedicated cargo aircraft of late, but you've been quite successful at extending all of your ACMI contracts with your key strategic partners here. I'm just trying to wrestle between those two dynamics and hoping you could speak to some of the supply side dynamics in terms of future capacity coming from those other carriers, and whether that impacts your ability to deploy new aircraft or not at all. Thanks.

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

Jamie, you want to take that?

Jamie Porteous, Chief Strategy Officer, Cargojet Canada Ltd.

Yes, I think—just to clarify, you're specifically talking about other domestic cargo operators, like Air Canada and WestJet, and if so—on the--WestJet hasn't even started operating their 737s, they're still parked in Calgary. I think they've intended to or proposed an intended domestic schedule which really doesn't match up and doesn't compete at all with our—from what we've seen, with our domestic overnight network, and really part of the reason that we extended and renewed the agreements with our major customers was to alleviate that competitive question that people had.

In terms of Air Canada, they're operating 767s, but as we've noted before, where we see those aircraft flying, they're primarily—not primarily, they're exclusively on international routes where Air Canada Cargo had strong belly cargo capacity and demand pre-COVID, where they continued to support those historical belly cargo customers during COVID, flying passenger aircraft without passengers, and then those routes that had had—a good example would be from Bogota, Colombia to Toronto, connecting to their international network, where now as passenger travel has been reinstated, it's reinstated with more narrow body aircraft that don't have the belly cargo carrying capabilities that the aircraft that were operating on that route pre-COVID. They can use that to compensate and ensure that cargo demand that they have.

Again, those aren't markets that we compete in. We're very confident in obviously our domestic and our ACMI business and our capability of competing under a liability level, and we have a 20-year plus track record to stand on.

Steven Enson, Raymond James

It really is the demand environment that is critical in terms of deploying your aircraft going forward, nothing to do with the supply side (inaudible)?

Jamie Porteous, Chief Strategy Officer, Cargojet Canada Ltd.

Correct.

Steven Enson, Raymond James

Very helpful, thank you.

Operator

Thank you.

The next question is from Fadi Chamoun with BMO Capital Markets. Please go ahead, your line is now open.

Michael Goldie, BMO Capital Markets

Hi, this is Michael Goldie on for Fadi.

How is 1Q23 tracking so far, both in the domestic network and ACMI? Is softness extending from December, or is there some sort of improvement?

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

Jamie?

Jamie Porteous, Chief Strategy Officer, Cargojet Canada Ltd.

Yes, morning Michael.

I think certainly the peak period, as Ajay was alluding to earlier, was somewhat of a unique peak period for us. It was very strong in October-November and then we just saw after U.S. Thanksgiving some deterioration in demand that impacted us in December, which historically December is usually the heaviest month. I think that plateaued in December and what we've seen in January and February so far on the domestic side is a little bit flat, a little low digit, as we commented earlier, low single digit year-over-year revenue growth. The ACMI business is still up because of the very fact of the three additional routes that I noted before, that we started for DHL in 2022 that we'll get the full annualized impact in 2023, although on a macro level maybe on lower block hours, still well above the minimum just because of the nature of the routes that we're flying those aircraft versus what we may have been flying in 2022.

Michael Goldie, BMO Capital Markets

Okay.

How is the charter market looking right now? I think you were able to get more than expected revenues there in the fourth quarter. Is that continuing into the new year, or coming out of peak charter opportunities are a bit lighter now?

Jamie Porteous, Chief Strategy Officer, Cargojet Canada Ltd.

No, demand for charters has remained very strong. We took advantage of the opportunity in Q4 because—particularly in the month of December where, again, historically because of the peak season, capacity demands for the domestic network and for the ACMI network, we actually historically always embargo active charters during the month of—latter part of November and December, because we typically need those aircraft and crews to support the peak volume needs of our domestic and ACMI business. When we saw that softening, we freed up aircraft and crews and we took on additional charter business, ad hoc charter business in the month of November and December, significantly than we would have normally in Q4. We're seeing that trend continue into January and February, and we're going to take advantage of that opportunity by freeing up additional aircraft. As Ajay said, we're bringing aircraft into the fleet to replace our operational c-check and hot spares, but we'll also designate aircraft and add more flexibility to designate aircraft as dedicated to charters going into this year. The demand, at least for the first month and a half, has stayed very strong.

Michael Goldie, BMO Capital Markets

Okay, perfect. Thank you very much, guys.

Ajay Virmani, President, Chief Executive Officer, Cargojet Canada Ltd.

I mean, keep in mind in 2022, we had lots of—in January and February, we had a lot of PPE and China charters because people were running out of masks and other—yes, we don't have that kind of charters today, where supplies for COVID are still being carried. There would be some differential. But as the market generally goes for charters without the COVID impact, we're seeing quite a few charters going on.

Operator

Thank you. There are no further questions registered at this time. I would like to turn back the meeting over to the moderators.

Pauline Dhillon, Chief Corporate Officer, Cargojet Canada Ltd.

Thank you, everyone. Appreciate you joining us for today's call. Have a good week.

Operator

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