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November 10, 2017

## RBC Flight Deck

### December holiday activity looks good

**Fares vary widely between Air Canada and WestJet.** After Air Canada and WestJet posted fare growth in the third quarter (excluding the impact from stage length), our Fare Tracker indicated that Air Canada increased prices even further and fares are now tracking 5.6% higher Y/Y, while WestJet posted fare declines of 3.8%. When considering stage length impacts, we adjust down 250bp for Air Canada and 50bp for WestJet. After these adjustments, yields point to +3.1% for Air Canada (vs. our estimate for Q4/17 of +1.0%) and -4.3% for WestJet (vs. our estimate of +2.5% for Q4/17).

**WJA's October traffic statistics and our Fare Tracker point to accelerated capacity growth until year-end.** WestJet reported traffic numbers this morning that showed its capacity growth was more than covered by demand. Traffic grew 4.5% (below our 6.0% estimate), while capacity increased 1.9% (well below our 6.0%). However, during its Q3 call on October 31, the company guided for system-wide Q4 capacity growth of 5.5% to 6% (and domestic growth of 7.5%-8.0%). We believe this lower capacity growth in October is more a function of the pace of the rollout, as opposed to a change in strategy. We expect to see capacity growth accelerate in November and December, which would be consistent with WestJet having a weaker booking curve in our tracker. We note however, that WestJet transported a record number of monthly passengers yet again in October, and the company indicated that "a lot of the capacity adds" will be to accommodate a rebounding economy in Alberta, where traffic has been hobbled in recent years by low oil prices.

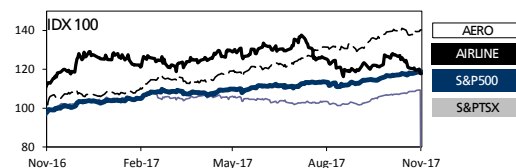
**Air Canada's international segments maintain pricing, domestic fares drive pricing gains.** Our Fare Tracker picked up relatively flat pricing for the company's international destinations while fares in the domestic segment posted strong increases Y/Y. More specifically, fares around the December holidays are attributable for a significant portion of the gains. The strong traffic numbers posted in WestJet's traffic statistics are a good barometer for Air Canada, which coupled with strong prices picked up in our Fare Tracker drive our continued conviction on the name.

#### In This Edition...

- **RBC Fare Tracker (p. 2):** Seeing positive fare growth, as per the RBC Fare Survey.
- **The Load Factor (p. 3):** Traffic demand remains robust.



INDEX	1-M (%)	YTD (%)	1-YR (%)	TREND
S&PTSX	2.2	5.1	8.9	Δ
S&P 500	1.2	15.0	19.0	Δ
AMEX Airline	(6.4)	(6.2)	4.0	▼
AMEX Aerospace	(1.1)	30.2	33.7	▼



COMMODITIES	1-M (%)	YTD (%)	1-YR (%)	TREND
WTI	14.4	(0.4)	13.3	Δ
Jet Fuel	9.5	15.6	35.9	Δ
CAD/USD	1.1	(5.5)	(5.4)	Δ

AEROSPACE				
Bombardier	37.6	40.1	70.8	Δ
Boeing	1.2	67.9	80.2	Δ
EADS	5.8	33.8	54.9	Δ
Embraer	(11.5)	3.5	(8.6)	▼
General Dynamics	(6.5)	15.6	23.1	▼
Textron	(1.8)	11.9	26.8	▼
United Technologies	(0.2)	8.0	13.0	▼

N.A. MAINLINE				
Air Canada	(11.5)	72.8	83.4	▼
AMR	(9.6)	(2.0)	7.9	▼
Delta	(4.2)	0.8	9.5	▼
United	(9.9)	(20.0)	(3.0)	▼

N.A. REGIONAL				
Alaska	(22.8)	(30.0)	(15.1)	▼
Allegiant	(4.5)	(23.6)	(13.9)	▼
Chorus Aviation	10.8	30.7	53.9	Δ
JetBlue	(2.3)	(15.0)	3.1	▼
SkyWest	(0.8)	26.1	44.7	▼
Southwest	(6.9)	7.7	26.6	▼
WestJet	(5.2)	9.8	20.9	▼

INTL AIRLINES				
Lufthansa	10.4	115.8	115.0	Δ
Air France/KLM	(16.1)	116.0	106.0	▼
BA/Iberia	(2.2)	35.2	34.9	▼
Cathay Pacific	(17.4)	(51.4)	(47.8)	▼
Air China	8.1	45.7	41.9	Δ
China Eastern	(0.5)	9.9	11.1	▼
China Southern	7.7	46.2	34.8	Δ
Singapore Airlines	6.3	12.0	8.6	Δ
Qantas	(2.6)	80.8	99.3	▼

Source: Bloomberg

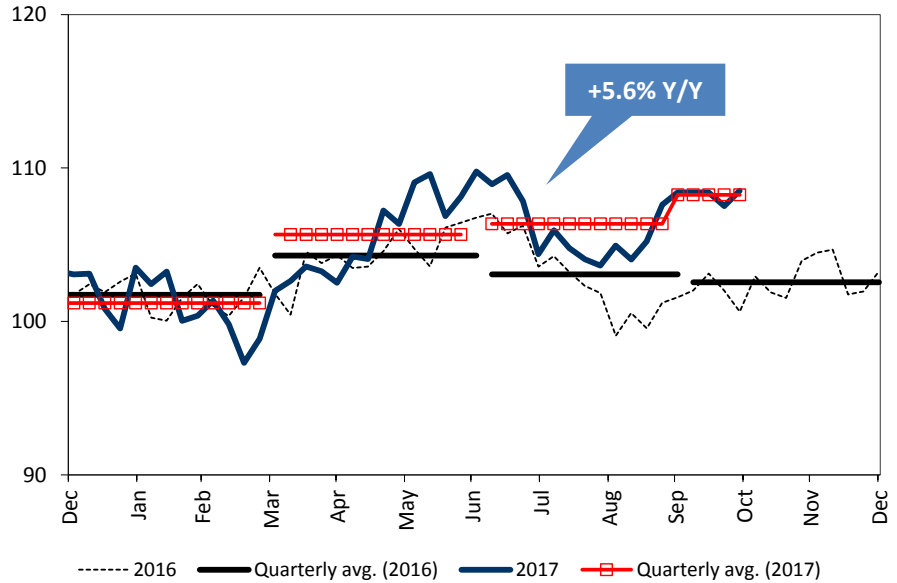


### RBC Fare Survey

We present below the results of our RBC Fare Tracker. This proprietary algorithm provides investors a unique snapshot of Air Canada and WestJet’s ticket pricing strategies ... and a window into yield growth trends *before* they are announced.

#### Air Canada

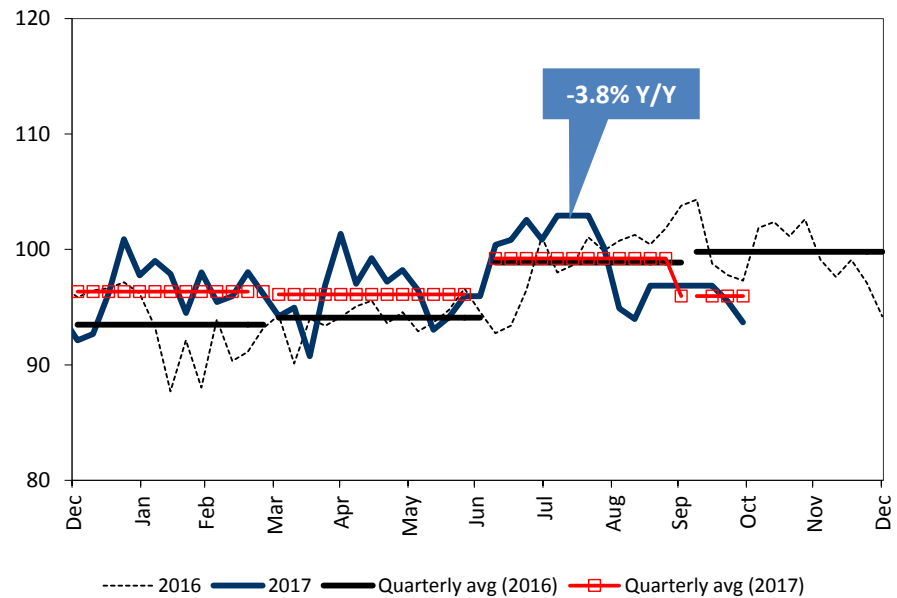
Fares at Air Canada were tracking well above last year’s levels, driven by strong gains in domestic fares. Transborder and International fares remained relatively flat for October on a month-over-month basis, while Air Canada’s vacation segment had a more pronounced drop. A deeper dive into the data reveals that the forward booking curve of domestic fares saw a notable increase around the three-month mark from holiday booking. Across all segments, the RBC Fare Survey tracked fare price increases of +5.6% Y/Y for Air Canada during October. When adjusting 250bp to account for stage length changes, our tracker points to a yield increase of 3.1%, above our 1.0% estimate for Q4/17.



Source: RBC Capital Markets estimates, Company websites

#### WestJet

The RBC Fare Survey is now pointing to lower fares, both on a month-over-month and year-over-year basis. For October, the RBC Fare Survey Tracker shows prices are down -3.8% Y/Y for WestJet. After adjusting down by 50bp to account for stage length changes, it implies a yield of -4.3%, which is below our Q4/17 yield estimate of +2.5%. Our Fare Tracker indicates the weakness is driven by the Transborder and Vacation segments, while WestJet’s domestic fares have only seen modest declines.

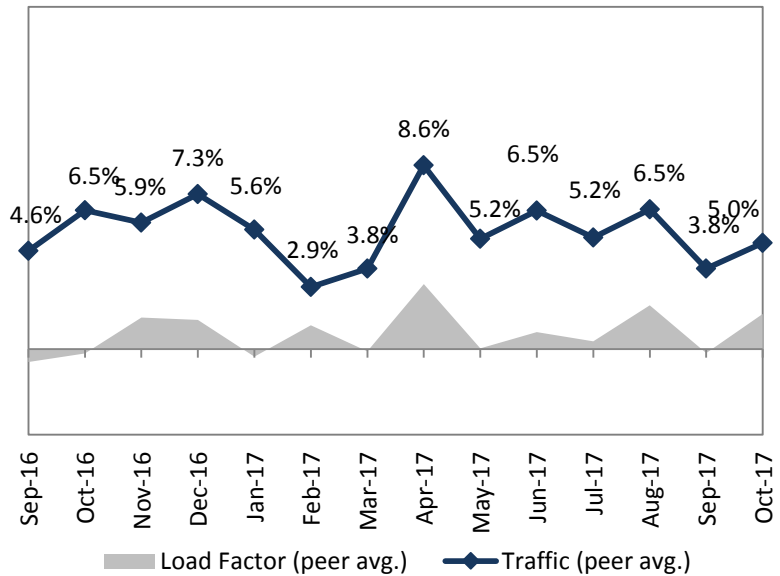


Source: RBC Capital Markets estimates, Company websites

## The Load Factor

### Industry trends

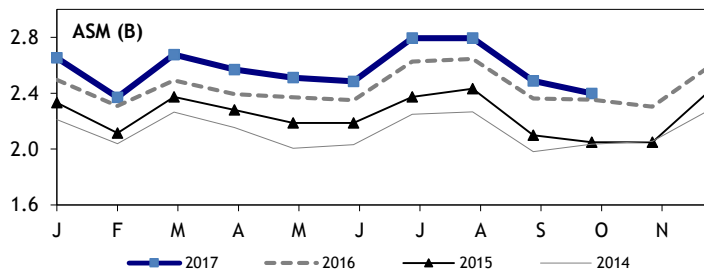
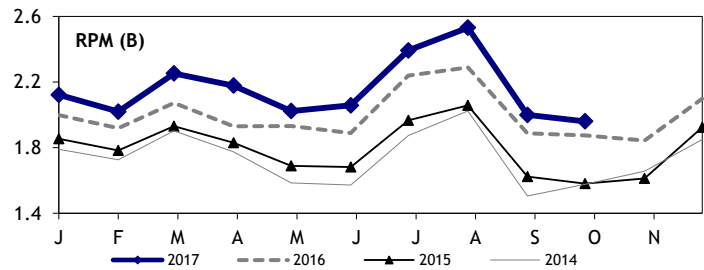
On average, the peer group reported 5.0% traffic growth in October, above the average capacity growth of 3.3%, leading to load factor growth of 1.6%. So far this year, North American carriers have managed traffic growth quite well, as traffic growth has exceeded capacity growth for 7 out of 10 months and the YTD monthly average load factor gain stands at +0.8%.



Sources: Company websites, RBC Capital Markets estimates

### WestJet

WestJet reported slower capacity growth in October, up only 1.9% compared to our estimate of 6% and below the guidance provided by management for Q4 capacity of 5.5% to 6.0%. Traffic certainly kept pace, up 4.5% Y/Y and nicely above the capacity level (but below our 6% assumption given the lower capacity). This led to a system load factor at 81.7% (up 200 points Y/Y – and another monthly record for the company).



	October			YTD		
	2017	2016	Δ	2017	2016	Δ
RPMs (B)	1.960	1.875	+4.5%	21.535	20.027	+7.5%
ASMs (B)	2.398	2.353	+1.9%	25.738	24.398	+5.5%
Load Factor	81.7%	79.7%	2 pts	83.7%	82.1%	1.6 pts

Metrics	
Traffic:	Revenue Passenger Miles = RPMs (billions)
Capacity:	Available Seat Miles = ASMs (billions)
Utilization:	Load Factor = RPMs / ASMs

Source: RBC Capital Markets estimates, Company websites



## Air Buzz

As part of RBC Flight Deck, we highlight news with implications relevant to the Canadian aerospace industry, in particular as related to Bombardier and CAE.

### Bombardier

#### Narrow-bodies

- **Bombardier obtained a letter of intent for up to 61 C Series jets.** The deal includes a firm commitment for 31 jets and an option for 30 more. Based on current list prices, the deal will be worth \$2.4 billion. The order will be free of import tariffs as the customer is Europe based. Air Insight reports the order comes from a new customer, which has two major implications. First, another party has found the C Series satisfactory after due diligence. Second, given such a short time frame between the Airbus JV announcement and this deal closing, Bombardier and this new customer must have been in the decision process before Airbus became involved. (Air Insight, November 2; Reuters, November 2)
- **Bombardier lowered 2017 C Series deliveries guidance.** Delays with the plane's engine forced the company to push down guidance for deliveries to a range of 20 to 22 aircraft from the previous 30 target. Pratt & Whitney, the maker of the engine, gave assurances the issue was short term. (Reuters, November 2)

#### Regional Jets

- **Embraer scored a firm order for ten E175s with American Airlines.** The new order comes on top of the one placed by AAL in April for four aircraft and is valued at \$457 million at current list prices. Embraer has now sold over 390 E175 jets, which is the company's top selling jet. (Air Insight, October 31)
- **Aircraft maker ATR secured a \$1.3 billion order from FedEx.** The European manufacturer, which emerged from a joint venture between Airbus and Italy-based Leonardo S.p.A., obtained a firm order for 30 ATR 72-600 turboprops, with an option for 20 more. Deliveries are not expected until 2020, at which point the planes will be deployed in the US market. The total order is valued at \$1.3 billion at current list prices. (Wall Street Journal, November 8)

#### Business Jets

- **Bombardier's Global 7000 made its trade show debut.** After its successful maiden flight in September, the plane made its international debut at a trade show in Las Vegas. David Coleal, Bombardier's Business Aircraft President, confirmed the Global 7000 remains on track for late 2018 deliveries and is sold out until 2021. (Reuters, October 8)



## CAE

### Civil

- **FlightSafety makes strides in Civil training contracts** – FlightSafety announced an expansion of its long-term partnership with Envoy Air, where the company has been selected to serve as a partner in the Envoy Pilot Cadet program. The Academy has a fleet of close to 90 aircraft, and accommodates 300 trainees on-site, with a library, pilot shop and other amenities similar to that of a university. FlightSafety is currently the exclusive training services provider for Envoy Air, supporting the training of pilots who fly a range of aircrafts including Bombardier CRJ 700, Embraer ERJ 15 and Embraer E175. (Flight Safety, Nov 7, 2017)
- **Airlines seek innovative ways address pilot shortage by helping to finance pilots' early education:** Cebu Pacific Airlines announced that will invest US\$25 million/yr in its Cadet Pilot training program launched in October that helps to finance pilots' early education. Cebu commented that pilot training could be a high-risk investment, with high initial training fees and no guarantee for employment. Under the program, aspiring pilots can study and train, with the airline financing the training course. Successful candidates will undergo a 56-week training program, and will be offered employment by the airline after graduation; the new pilots will then pay for the training cost through salary deduction over the next 1-10 years. Cebu will employ a mix of flight simulator training and in-aircraft training for its new pilot training operations. (Philippine Star, Oct 25 2017)

### Military

- **FAA recommends accelerated pilot training – to lower mandatory training hours from 750-1,250 hours down to 500 hours of flight time:** In response to the ongoing pilot shortage issue, an FAA advisory committee has recommended a training module that would lower the in-air training time to be lowered from 750-1,250 hours (depending on experience) down to 500 hours, with the remainder to be completed in classrooms or on simulators. The Air Line Pilot Association (ALPA) was not supportive of the recommendation, highlighting that it will undermine the valuable training and experience necessary to become a safe and qualified pilot. The U.S. commercial airline industry is facing a shortage of ~1,000 pilots – this number is anticipated to double next year, and grow fourfold by 2022, as around 13,000-15,000 pilots will retire within this timeframe. (TW, FAA, Oct 27 2017)



## The Landing Strip

### Dubai Air Show

**When:** November 12-16

**Where:** Dubai, United Arab Emirates

**What:** The Dubai Air Show is the biggest airshow in the Middle East, and one of the world's top aerospace events.

**The Buzz:** The event has seen massive orders placed over the years. The 2015 event attracted over 1,000 exhibitors and 66,000 trade visitors. More impressively though, airlines built up an order book of \$37.2 billion.



Appendix 1: Airline Comparables

Symbol	09-Nov-17 Price	EV/EBITDAR				EV/Sales				EBITDAR Margin				Net Debt to EBITDAR	EV (MM)		
		2016	2017E	2018E	2019E	2016	2017E	2018E	2019E	2016	2017E	2018E	2019E				
<b>Discount Airlines</b>																	
WestJet	WJA-CA	C\$	\$25.16	5.4x	5.3x	4.8x	4.7x	1.3x	1.2x	1.1x	1.0x	24%	22%	22%	21%	2.1x	5,272
Southwest	LUV-US	US\$	\$53.46	6.2x	6.7x	5.8x	5.5x	1.7x	1.6x	1.5x	1.5x	27%	24%	26%	27%	0.4x	34,289
JetBlue	JBLU-US	US\$	\$18.83	4.3x	5.1x	4.8x	4.5x	1.3x	1.2x	1.1x	1.1x	30%	24%	23%	23%	1.4x	8,464
<b>Discount Average</b>				<b>5.3x</b>	<b>5.7x</b>	<b>5.2x</b>	<b>4.9x</b>	<b>1.4x</b>	<b>1.3x</b>	<b>1.2x</b>	<b>1.2x</b>	<b>27%</b>	<b>23%</b>	<b>24%</b>	<b>24%</b>	<b>0.9x</b>	
<b>Mainline Airlines</b>																	
Air Canada	AC-CA	C\$	\$23.42	4.7x	4.6x	4.1x	3.9x	0.9x	0.8x	0.8x	0.8x	19%	18%	19%	19%	2.0x	13,111
Delta Air Lines	DAL-US	US\$	\$49.19	5.0x	5.1x	4.8x	4.9x	1.1x	1.1x	1.0x	1.0x	22%	21%	21%	20%	0.9x	43,016
United Continental	UAL-US	US\$	\$58.39	4.2x	5.0x	5.0x	4.7x	0.9x	0.9x	0.8x	0.8x	21%	17%	16%	17%	2.3x	31,988
American Airlines	AAL-US	US\$	\$45.77	5.5x	6.5x	6.3x	6.0x	1.1x	1.1x	1.0x	1.0x	20%	16%	16%	16%	3.2x	44,624
<b>Mainline Average</b>				<b>4.9x</b>	<b>5.3x</b>	<b>5.1x</b>	<b>4.9x</b>	<b>1.0x</b>	<b>0.9x</b>	<b>0.9x</b>	<b>0.9x</b>	<b>20%</b>	<b>18%</b>	<b>18%</b>	<b>18%</b>	<b>2.1x</b>	
<b>Regional Airlines</b>																	
Chorus Aviation	CHR-CA	C\$	\$9.40	9.6x	8.3x	7.3x	6.9x	2.4x	2.3x	2.3x	2.2x	25%	28%	31%	32%	4.7x	3,122
SkyWest Inc.	SKYW-US	US\$	\$45.80	6.3x	6.2x	6.4x	6.4x	2.1x	2.1x	2.1x	2.0x	34%	34%	32%	32%	4.1x	6,644
<b>Regional Average</b>				<b>8.0x</b>	<b>7.2x</b>	<b>6.8x</b>	<b>6.6x</b>	<b>2.3x</b>	<b>2.2x</b>	<b>2.2x</b>	<b>2.1x</b>	<b>29%</b>	<b>31%</b>	<b>32%</b>	<b>32%</b>	<b>4.4x</b>	
<b>Airline Average</b>				<b>5.7x</b>	<b>5.9x</b>	<b>5.5x</b>	<b>5.3x</b>	<b>1.4x</b>	<b>1.4x</b>	<b>1.3x</b>	<b>1.3x</b>	<b>25%</b>	<b>23%</b>	<b>23%</b>	<b>23%</b>	<b>2.4x</b>	

Sources: Company reports, FactSet, and RBC Capital Markets estimates for Air Canada, Chorus Aviation, and WestJet. Priced at the close on November 09, 2017



## Companies mentioned

Air Canada (TSX: AC CN; C\$23.42; Outperform; Speculative Risk)

CAE Inc. (TSX: CAE.TO; C\$22.88; Sector Perform)

WestJet Airlines Ltd. (TSX: WJA.TO; C\$25.16; Sector Perform)

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**Ratings**

**Top Pick (TP):** Represents analyst's best idea in the sector; expected to provide significant absolute total return over 12 months with a favorable risk-reward ratio.

**Outperform (O):** Expected to materially outperform sector average over 12 months.

**Sector Perform (SP):** Returns expected to be in line with sector average over 12 months.

**Underperform (U):** Returns expected to be materially below sector average over 12 months.

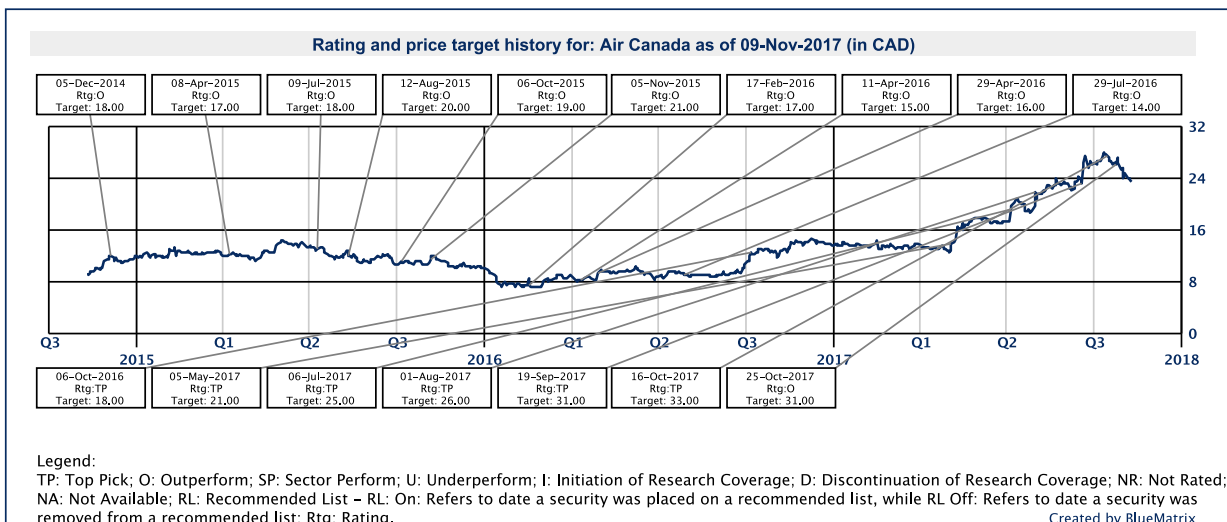
**Risk Rating**

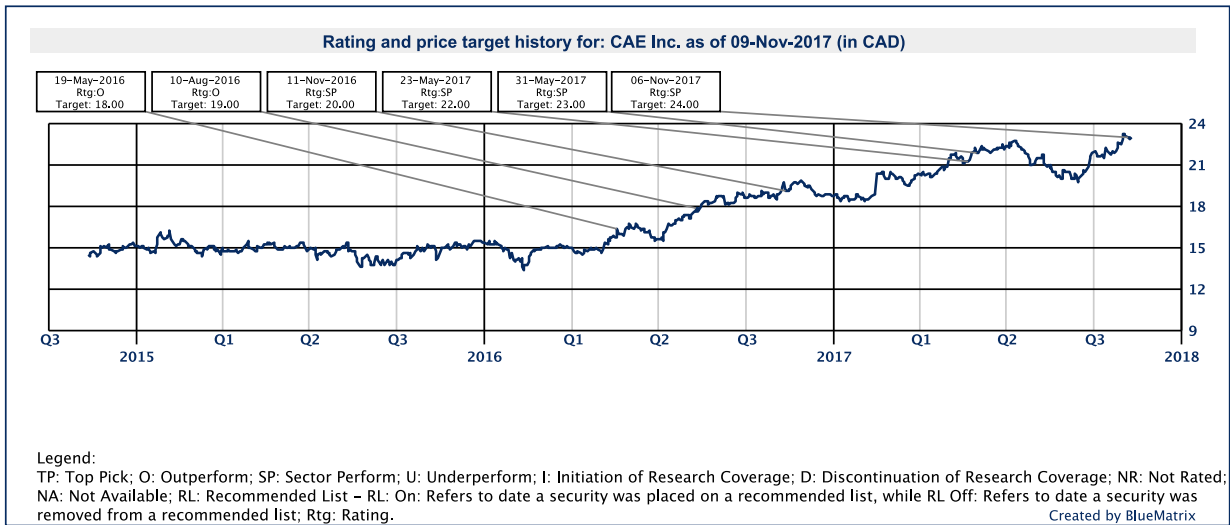
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Distribution of ratings RBC Capital Markets, Equity Research As of 30-Sep-2017				
Rating	Count	Percent	Investment Banking Serv./Past 12 Mos.	
			Count	Percent
BUY [Top Pick & Outperform]	859	52.92	294	34.23
HOLD [Sector Perform]	660	40.67	154	23.33
SELL [Underperform]	104	6.41	7	6.73





References to a Recommended List in the recommendation history chart may include one or more recommended lists or model portfolios maintained by RBC Wealth Management or one of its affiliates. RBC Wealth Management recommended lists include the Guided Portfolio: Prime Income (RL 6), the Guided Portfolio: Dividend Growth (RL 8), the Guided Portfolio: ADR (RL 10), and the Guided Portfolio: All Cap Growth (RL 12), and former lists called the Guided Portfolio: Large Cap (RL 7), the Guided Portfolio: Midcap 111 (RL 9), and the Guided Portfolio: Global Equity (U.S.) (RL 11). RBC Capital Markets recommended lists include the Strategy Focus List and the Fundamental Equity Weightings (FEW) portfolios. The abbreviation 'RL On' means the date a security was placed on a Recommended List. The abbreviation 'RL Off' means the date a security was removed from a Recommended List.

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## Air Canada

### Valuation

Our \$31.00 target price is based on a 4.5x EV/EBITDAR multiple applied to our 2019 estimates, which is at a discount to the peer average of 5.2x owing to the currently higher leverage and lower operating margins compared to peers. Our base case reflects the following assumptions: (1) modest yield declines due to changing business mix related to AC's strategic transformation; (2) fleet expansion and strong demand to drive traffic growth; and (3) jet fuel prices to remain relatively range-bound at current levels. Our price target supports our Outperform, Speculative Risk rating. Due to high debt leverage and operating in a cyclical sector, we believe a Speculative Risk qualifier is warranted.

### Risks to rating and price target

Risks to our price target and rating include but are not limited to very high operating leverage given a fixed-cost structure, above-average sensitivity to the economy, exposure to volatile fuel prices and the risk of terrorism and epidemics. This is a very competitive industry in which WestJet is capturing domestic market share. Air Canada is only partially hedged to changes in jet fuel prices.

## CAE Inc.

### Valuation

Our 12-month price target is based on a blend of P/E, EV/EBITDA, and DCF metrics, applied to our estimates on a rolling two-year forward basis. We apply target multiples of 11x EV/EBITDA and 20x P/E to our 2-year forward (FQ2/19E–FQ1/20E) estimates. These multiples reflect strength across A&D sector and growing confidence in CAE's execution and long term ROIC focus, and are inline with A&D peers with similar commercial/military exposure. Our price target of \$24 supports our Sector Perform rating.

### Risks to rating and price target

- Global military expenditures, particularly US expenditures, decline significantly, overly impacting simulator/training demand in the military segment.
- Competitive pressures from new upstarts and integrated aerospace/defense companies could impact revenues and margin, particularly in the event of an economic downturn.
- Decline in financial health of airline operators / manufacturers that may place airplane purchases on hold.
- Intensifying competitive environment as aerospace and defence companies consolidate or develop greater capabilities around the simulation and training space.
- FX fluctuations, particularly with a strengthening C\$, could negatively impact financial results.

## WestJet Airlines Ltd.

### Valuation

Our \$28 price target is based on an EV/EBITDAR approach whereby we apply a 5.1x multiple to our 2019 estimate and is the basis of our Sector Perform rating. Our target multiple is a slight discount to recent LCC peer multiples, reflective of the execution risk and costs associated with the company's international and regional growth strategy.

### Risks to rating and price target

Risks to our price target and rating include but are not limited to the price of jet fuel, which is tied to oil prices, the strength of the domestic economy, the competitive environment, and the ability to maintain a growth company valuation. Airline stocks in general are volatile and can significantly underperform or outperform the broader market on sentiment.

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