

PALOS

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Weekly Commentary

Issue No. 34 | AUGUST 10, 2020

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By Charles Marleau, CIM

One Airline That's Flying High But It's Not Carrying People!

Cargojet, Inc (TSX: CJT) is a Canadian based air cargo transportation and services company. Cargojet's core business focuses on the fulfillment of time sensitive, overnight delivery needs of its retail and small-to-medium sized business customers. The company's cargo segment enjoys a 90% domestic market share thus making CJT Canada's #1 cargo carrier by a country mile. Roughly three-quarters of CJT's cargo-based revenues are derived from long-term contracting with familiar names like Canada Post/Purolator, United Parcel Service, and TFI International. The company also operates charter routes for DHL. Aside from cargo, CJT also operates an 'Aircraft, Crew, Maintenance and Insurance' (ACMI) segment and a charter flights segment.

Further enhancing the strength of its customer base was the company's 2019 strategic agreement with Amazon (AMZN). The agreement included the issuing of warrants which will ultimately lead to AMZN taking a 15% stake in the company. Incorporated in the terms of the agreement, is a pledge from Amazon to direct up to \$600 million in business revenue to Cargojet. This virtually assures a stable source of future revenue growth from a reliable ally.

On August 6, CJT released blowout second quarter results that far exceeded analysts' expectations. Revenues soared to \$196 million for the quarter versus \$119 million for same quarter 2019. EBITDA came in at \$91 million versus \$37 million in Q2/2019. Revenue strength was attributed to skyrocketing e-commerce related demand for Business to Client (B2C) package delivery services. According to StatsCan, e-commerce sales as a percentage of total retail sales has doubled year-over-year and this trend is likely to continue. In May 2020, e-commerce sales in Canada were up 120% versus May 2019.

During normal times, passenger aircraft capacity augments commercial capacity by carrying cargo in the aircraft's underbelly storage compartments. While Business to Business (B2B) commerce has fallen off during the slowdown, international cargo capacity has been reduced by an even greater amount. CJT's charter segment, which is the smallest, accounted for \$77 million in revenue versus \$7 million for 2019. Charter received a strong Q2 boost from government procurements of PPE and emergency medical supplies flown in from Asia. Management believes that the short-term revenue boost from the charter segment may decelerate in a post Covid world.

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Cargojet's fleet of 26 aircraft services fifteen cities in Canada and several international destinations. CJT transports over 8 million pounds of cargo on a weekly basis. While the long-term economic damage from Covid are still an unknown, management did highlight their satisfaction with the company's ability to accommodate the surge in demand. ACMI revenue was up 107% from same quarter 2019, largely due to an increase in international business with DHI.

CJT is well positioned to take advantage of the acceleration in e-commerce adaptation which in turn, will drive demand for B2B and B2C fulfillment for years to come. The company plans to direct its increasing cash flows towards paying down debt, and to pursue potential growth opportunities, this according to President and CEO Ajay Virmani. We believe that CJT will continue to be the leader in Canada for all air cargo. CJT should be able to defend its dominance as the company has built an impressive network of alliances and secured long-term contracts with the major players in Canada. We are bullish on Cargojet and we hold shares of CJT in the Palos Income Fund.

Disclaimer: Palos Funds are shareholders of CJT.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$7.67	-4.05%
Palos Equity Income Fund - RRSP	PAL101	\$5.50	-2.69%
Palos Merchant Fund L.P. (Dec 31, 2019) ²	PAL500	\$1.71	20.15%
Palos WP Growth Fund - RRSP	PAL210	\$9.25	20.84%
Palos-Mitchell Alpha Fund ³	PAL300	\$8.62	-16.94%
S&P TSX Composite (Total Return with dividends reinvested)			-1.08%
S&P 500 (Total Return with dividends reinvested)			4.93%
S&P TSX Venture (Total Return with dividends reinvested)			28.38%
Chart 2: Market Data ¹			Value
US Government 10-Year			0.56%
Canadian Government 10-Year			0.48%
Crude Oil Spot			US \$41.22
Gold Spot			US \$2010.10
US Gov't10-Year/Moody BAA Corp. Spread			258 bps
USD/CAD Exchange Rate Spot			US \$0.7472

¹ Period ending August 7, 2020. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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