Canadian Helicopters Group Inc. (CHL.A C$25.00, TSX)

No surprises in 2Q11 results; outlook and investment thesis unchanged; maintaining Top Pick rating and C$33 target

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Canadian Helicopters Group Inc.

Rating		Top Pick–Average Risk
Target		C$33.00
Symbol		CHL.A
Exchange		TSX
Sector		Transportation & Aerospace
Closing price		C$25.00
Potential return		36%
52-week range		C$13.40–27.05
Shares O/S		13.1m
Market cap		C$328m
TSX weighting		0.0%
Year-end		Dec-31
Revenue	2010A	C$171m
	2011E	C$250m
	2012E	C$269m
Adj EPS	2010A	C$1.86
	2011E	C$3.36
	2012E	C$3.38
P/E	2010A	13.4x
	2011E	7.4x
	2012E	7.4x
Book value/sh		C$14.35
LQ ROE		22.1%
Debt/total capital		-
Net debt/LTM EBITDA		-
Dividend		C$1.10
Dividend yield		4.4%
Quarterly data		
Adj EPS 3Q11E	Desjardins	C$1.38
	Consensus	C$1.40
Adj EPS 3Q10A		C$1.09

Source: Desjardins Capital Markets

Highlights

2Q results in line with our estimates, driven by Afghanistan and mining activity. Canadian Helicopters (CHL) reported solid 2Q11 results last Thursday (August 11) after the market close. Revenue of C$63.3m was in line with our estimate of C$64.3m, while EBITDA of C$23.2m was ahead of our forecast of C$21.9m. This translated into EPS of C$1.07 (assuming a normalized tax rate of 30%), in line with our C$1.07 forecast and stronger than consensus of C$0.93. The strong performance was due to a solid contribution from the Afghanistan contracts (which carry higher margins), as well as higher activity in the mining sector. Revenue flying hours increased by 27% to 19,776, and average revenue per hour flown increased 12% to C$2,800.

Management confident in military outlook; upcoming contract could provide further upside. Management's outlook is unchanged, and CHL remains confident that it will continue to generate "strong revenues" from Afghanistan in the quarters ahead. The company's current options in Afghanistan will expire in November and December 2011. Management indicated that despite the debt ceiling debate in the US, it is confident that revenue from this region will remain at current levels until at least the end of 2012 (in line with our forecast). Furthermore, pricing on this renewal is fixed, so we assume that margins on the Afghanistan contracts in 2012 will remain similar to 2011 levels. A US$35m contract with USTRANSCOM expires on November 30, 2011 (we estimate a revenue contribution of C$20m in 2011 and zero for 2012). However, the company bid on two additional contracts in Afghanistan recently, and although it lost one contract to a competitor, it remains in the running for the second opportunity, which would include eight helicopters (CHL currently has 11 helicopters in Afghanistan). The award of the contract is expected in the near future, and we believe this could more than make up for the expiration of the US$35m contract.

Valuation

Our estimates are largely unchanged. We have updated our model following the 2Q results. Overall, our estimates are largely unchanged. We have increased our revenue estimate for 2012 as we assume a stronger contribution from HNZ than previously expected, given the transaction closed in early 3Q (we had modelled closing in 4Q for conservatism). However, we are slightly increasing our interest expense forecast. Overall, we are increasing our adjusted EPS estimate to C$3.36 (from C$3.35) for 2011 and to C$3.38 (from C$3.37) for 2012.

Maintaining our C$33 target. Our C$33 target is the sum of our DCF estimate of the value of the recurring business of C$31.82 (up from C$31.31), assuming no Afghanistan options are exercised past 2011, and our estimate of the value of the 2012 options on the Afghanistan contracts—which we believe will be exercised—of C$1.53. Our target implies a 9.8x P/E multiple based on our 2012 adjusted EPS estimate and a 5.6x EV/EBITDA multiple based on our 2012 EBITDA forecast.

Recommendation

We believe several catalysts lie ahead for the stock and reiterate our Top Pick–Average Risk recommendation on CHL, with a C$33 target.

Highlights and implications

Revenue in line; EBITDA margin slightly stronger than expected. Revenue of C$63m in 2Q11 was in line with our estimate of C$64m and up 43% yoy, mostly due to the ramp-up in Afghanistan and, to a smaller extent, the increase in mining activity in eastern Canada. We estimate the revenue contribution from Afghanistan at about C$27m. Revenue also increased as a result of the consolidation of Heli-Welders and Nampa Valley Helicopter on the maintenance side of the business. EBITDA margin came in at 23.9%, stronger than our 21.7% estimate.

HNZ acquisition closed in early July; balance sheet remains solid. The HNZ transaction was completed on July 7 at a purchase price of NZ$154m (C$123m). CHL had entered into a new revolving credit facility totalling C$125m to finance the transaction. Management noted that the improvement in the level of activity in Australia was not as strong as in Canada. Post-acquisition, CHL's balance sheet should remain solid, with a net-debt-to-EBITDA multiple of ~1.2x, well below the peer average of ~2.7x (management is comfortable with a ratio of 2.0–2.5x). We reiterate our view that CHL is well positioned to pursue further acquisitions following the integration of HNZ. We believe the company might be concentrating its due diligence efforts on military support in regions outside the US, given US foreign ownership restrictions. However, an acquisition on the MRO (maintenance repair overhaul) side in the US is a possibility, as this market is not subject to foreign ownership rules. There are also 4–5 Canadian companies in which CHL might be interested at the right price.

Exhibit 1: Revised forecast for Canadian Helicopters

		Old estimates		New estimates	
Year-end Dec-31	**2010**	**2011E**	**2012E**	**2011E**	**2012E**
Revenue (C$m)	170.7	244.4	262.6	249.8	268.5
EBITDA (C$m)	41.1	72.5	78.6	76.9	81.3
EBITDA (%)	22.8	29.6	29.9	30.8	30.3
Adjusted EPS (C$)	1.86	3.35	3.37	3.36	3.38

Source: Desjardins Capital Markets, company reports

Exhibit 2: Canadian Helicopters Group Inc. financial summary and breakdown

		Desjardins			Change (%)	
Year end Dec-31 (C$m)	**2Q11**	**2Q11E**	**1Q11**	**2Q10**	**Qoq**	**Yoy**
Revenue	63.3	64.3	46.9	44.4	35	42
Crew & maintenance	23.9	25.4	22.0	20.4	8	17
Crew & maintenance (%)	37.7	39.5	46.9	45.9	-20	-18
SG&A expense	10.4	11.6	10.7	9.6	-3	8
SG&A (%)	16.4	18.0	22.7	21.6	-28	-24
EBITDA	23.2	21.9	9.5	11.7	144	97
EBITDA margin (%)	36.7	34.1	20.1	26.4	83	39
Net income	15.1	13.9	4.8	1.2	NM	NM
Net margin (%)	23.9	21.7	10.2	16.4	134	46
EPS (C$)	1.15	1.07	0.37	0.09	211	NM
Adjusted EPS (C$)	1.07	1.07	0.40	0.52	168	106
Segmented information						
Revenue by division						
Helicopter transportation svcs	55.8	57.9	40.8	39.4	37	41
Other	7.5	6.3	6.1	5.0	23	50
Total	**63.3**	**64.3**	**46.9**	**44.4**	**35**	**43**
Other						
Free cash flow	6.1	15.4	8.5	-3.9	-29	-256
Capex	2.2	1.1	6.7	0.8	-68	170
Flying hours	19,776	-	10,252	15,560	93	27
Average revenue/hour flown (C$000)	2.8	-	4.0	2.5	-30	12

Source: Desjardins Capital Markets, company reports

Exhibit 3: Comparative valuation

Company (US$)	Ticker	Mkt cap ($m)	Share price ($)	1y chg (%)	EBITDA mgn (%)	Net mgn (%)	P/E[2] (x) TTM	P/E[2] (x) FY1	P/E[2] (x) FY2	EV/EBITDA[2] (x) TTM	EV/EBITDA[2] (x) FY1	EV/EBITDA[2] (x) FY2	TTM sls ($m)	P/S FY2 (x)	P/B (x)	Debt/cap (x)	Net dt/EBITDA (x)
Air Methods	AIRM	818	64.51	101.1	18.2	6.7	17.1	16.9	12.1	9.4	7.4	5.4	586	1.0	3.1	27.3	0.5
Bristow Group	BRS	1,510	41.30	25.3	19.3	6.6	11.3	10.7	9.2	10.2	7.3	6.6	1,262	1.0	1.0	32.2	2.5
Discovery Air[1]	DA.A	62	0.43	112.5	24.9	-6.9	8.5	6.4	4.9	5.1	4.7	4.3	164	0.3	0.8	67.9	3.7
PHI	PHIIK	249	20.01	41.4	11.1	0.5	NM	NA	NA	9.7	NA	NA	512	NA	0.7	40.2	3.9
Average				**70.1**	**18.4**	**1.7**	**12.3**	**11.3**	**8.7**	**8.6**	**6.4**	**5.4**		**0.8**	**1.4**	**41.9**	**2.7**
Median				**71.3**	**18.8**	**3.5**	**11.3**	**10.7**	**9.2**	**9.6**	**7.3**	**5.4**		**1.0**	**0.9**	**36.2**	**3.1**
Canadian Helicopters[1]	**CHL.A**	**328**	**25.00**	**84.5**	**29.6**	**17.8**	**8.7**	**7.4**	**7.4**	**6.8**	**5.0**	**4.5**	**208**	**1.2**	**1.7**	**32.0**	**1.2**

[1] Data in Canadian dollars; [2] Multiples greater than 70x are considered not meaningful
Note: Estimates from I/B/E/S and FirstCall, except for CHL.A (Desjardins Capital Markets)
Source: Desjardins Capital Markets, Bloomberg, I/B/E/S, FirstCall

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Hold	Hold	34	26	14	27
Sell	Sell	1	1	0	0
Total		**129**	**100**	**52**	**100**

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Average Risk	Above-average Risk	Speculative
Risk represented by the stock is in line with its peer group* in terms of volatility, liquidity and earnings predictability	Risk represented by the stock is greater than that of its peer group* in terms of volatility, liquidity and earnings predictability	High degree of risk represented by the stock, marked by an exceptionally low level of predictability

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