PHOTO: SIMON BLAKESLEY

Employee and Stakeholder Information Update

7 July 2022

We held both our annual general meeting and a board of directors meeting on June 28, and I would like to take the time to share highlights from both for our employees and other stakeholders. I know there is a lot of interest among all of you as to how the company fared in 2021, as well as a sense of what is ahead.

Financial & Operating Overview

Like most Canadian airlines and many, if not most, Canadian businesses and individuals, the past two and a half years have been extremely challenging. To date, as we near the end of Q2 2022, we have incurred more than $28 million in pre-relief losses since the start of the COVID pandemic. While federal and territorial assistance has offset about 61% of these losses to date, our net loss is huge for a company our size. It is pretty clear to me that the impacts of COVID and other extraneous forces are not yet behind us. While the Yukon market was well on its way to recovery in December, the Omicron variant triggered an almost 30% backslide. Now, just as we are on our way back up again, inflation—led by skyrocketing fuel costs—has the potential to throw another roadblock in front of the recovery.

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While 2021 showed much growth and improvement over 2020, we have not yet returned to pre-COVID performance. In 2019, we achieved a $7.3 million gross profit and in 2020, due to COVID, we achieved a $15.2 million pre-relief loss. In 2021 we reduced our pre-relief loss to $4.1 million. For 2022, we are currently forecasting a loss of at least $4 million.

Our passenger traffic declined from 256,697 in 2019 to 95,727 in 2020 and recovered to 145,544 in 2021. For 2022, we are currently forecasting our passenger numbers to reach close to 300,000. Passenger load factors were 72% in 2019, 49% in 2020, and 58% in 2021. Our 2022 load factors are currently sitting at 59%, with significant improvement expected for the remaining summer months. We need to get our load factors up, as this will help to mitigate the impact of higher fuel costs. Cargo volumes have remained fairly stable during the pandemic, at approximately four million pounds each year.

Average passenger yields have also remained fairly flat, at $208 in 2019 and $222 in both 2020 and 2021. For 2022, higher fuel costs will drive a need for higher airfares—but, to date, competitive dynamics have resisted airfare increases and we are currently averaging only $203.

In 2021, our year-over-year scheduled service flying revenue grew by 41% while charter flying revenues grew by 111%. Commercial fuel sales, including Air North's share of Chieftain sales, showed year-over-year growth of 39%. Meanwhile, ground handling revenues decreased by 59% as we curtailed most of our commercial ground handling activities. Total year-over-year consolidated revenues grew by 43% in 2021, providing some indication that the worst of COVID is behind us.

However, our recovery still has a long way to go, as scheduled service revenues are still 35% behind 2019 and charter revenues are 66% behind. Commercial fuel sales have almost completely recovered, and miscellaneous sales were 3% ahead of 2019. Ground handling revenues were 80% behind 2019, reflecting our efforts to exit these activities.

Operating expenses were up 22% in 2021 relative to 2020 and 13% less than in 2019. This resulted in an operating margin of ($3.0 million) in 2021, relative to an operating margin of ($13.8 million) in 2020. Government assistance provided under the Canada Emergency Wage Subsidy (CEWS), the Northern Essential Air Service (NEAS) and other programs amounted to $6.1 million in 2021, down from $11.0 million in 2020. Net results were a $1.6 million profit in 2021 relative to a loss of $4.2 million in 2020.

We are most thankful for the COVID relief funds provided by both the territorial and the federal governments as it would have been extremely challenging for us to maintain our essential services were it not for this help. To put the year-over-year numbers into perspective, in 2020 our passenger traffic declined by 63% relative to 2019. In 2021, traffic recovered by 52% relative to 2020—but we were still 43% behind 2019.

Financial and Operating Performance – Q1 & Q2, 2022

For the first half of 2022, we are ahead of our forecast in passenger numbers and ahead of our 2019 passenger numbers, while we are slightly behind forecast and slightly behind 2019 in cargo volumes. Both metrics are ahead of 2021 and 2020. June actually set an all-time record with 34,207 scheduled service passengers, and I expect July and August to do even better—provided that we don't have to cap or cancel flights.

Q1 and Q2 fuel cost per flight hour was $2,078 in 2019, $1,636 in 2020, $1,484 in 2021, and $2,978 in 2022. This is less than our variable budget of $3,016, but well over our forecast of $2,216. Fuel cost per hour relative to sked revenue per hour is a particularly telling statistic, at 31% in 2019, 29% in 2020, 31% in 2021, forecast for 30% in 2022—but this increases to 48% in our variable budget and 49% in our actual results.

Higher than forecast fuel costs, combined with lower than forecast yields and load factors, combined to produce disappointing financial results for Q1 & Q2 2022. It's not uncommon to lose money in the first half of the year—in 2019 we lost $142,000 in this period, yet finished the year with record results. In 2020 we incurred a pre-subsidy loss of $7.8 million in Q1 & Q2, and in 2021 we had a pre-subsidy loss of $5.4 million for the period. For Q1 & Q2 2022, we are currently showing a pre-subsidy loss of $8.5 million with no assurance of further financial relief. This is concerning.

The major influencers at play during Q1 and Q2 are summarized below.

Major Variables Q1 & Q2 2022

Variable	Variance %	Impact	Influence
Fuel Costs	36%	$ 4,028,732	Geopolitical
Load Factors	16%	$ 4,415,674	Omicron/Competition
Yield	8%	$ 2,267,007	Competition

PHOTO: SIMON BLAKESLEY

The data above illustrates the three major variables at play during Q1 & Q2 2022. Some have been changing rapidly, some are beyond our control, and some are within our control—but it's difficult to react to quickly without major reputational impact.

It is important to note that the speed at which fuel costs, competitor capacity, and yield have all been changing is unprecedented, and our ability to respond quickly is constrained largely by our regard for our customers in this small market. We hear lots of stories about flight cancellations and multi-day travel delays in southern markets where the large carriers change their schedules and cancel flights on very short notice. It would be difficult for us to do this in our small community.

At this point, given the dynamics at play, it is almost certain that our recovery from COVID will take a large backslide in 2022 and we will incur a significant loss for the year. Moving forward, we will need to take steps to increase control of our own situation. This is an industry-wide problem. A major regional peer has asked us if we could fly their northern scheduled service programs on a 3-month contract due to shortages in flight crews. This signals that major risks are at play and ahead for northern and remote air service, and this represents a critical time to engage with government.

Looking ahead, I see five major challenges on the horizon: fuel costs, inflation, competitive dynamics, labour and fleet modernization. These challenges, in combination, represent perhaps the largest we have faced since we started our jet service in 2002.

Fuel Costs

Fuel prices have almost doubled during the past year, with the largest increases occurring during the last 90 days. To illustrate, our average fuel cost per passenger in May was almost $50 more than it was in March. Like many other airlines, we have been both reluctant and unable to pass the full impact of fuel cost increases on to our customers because of competitive dynamics, and because we fear that it will stifle much-needed traffic growth and economic recovery. We hoped that the most recent cost increases would be a short-term anomaly but, unfortunately, this does not appear to be the case. This means that increased travel costs are on the horizon for Canadians and is particularly concerning for northerners because not all travel in the North is discretionary, and not all northerners can afford a big airfare increase. Higher airfares are bound to stifle demand for discretionary travel.

Inflation

Inflation, led by fuel, is running rampant in Canada and other countries. As a result, disposable income is getting squeezed for everyone. This will stifle discretionary spending and this will lead to reduced travel demand. While our economy is certainly booming right now, there is a lot of speculation that we are headed for a recession, and, if that is what's coming, then we should be taking steps now to prepare.

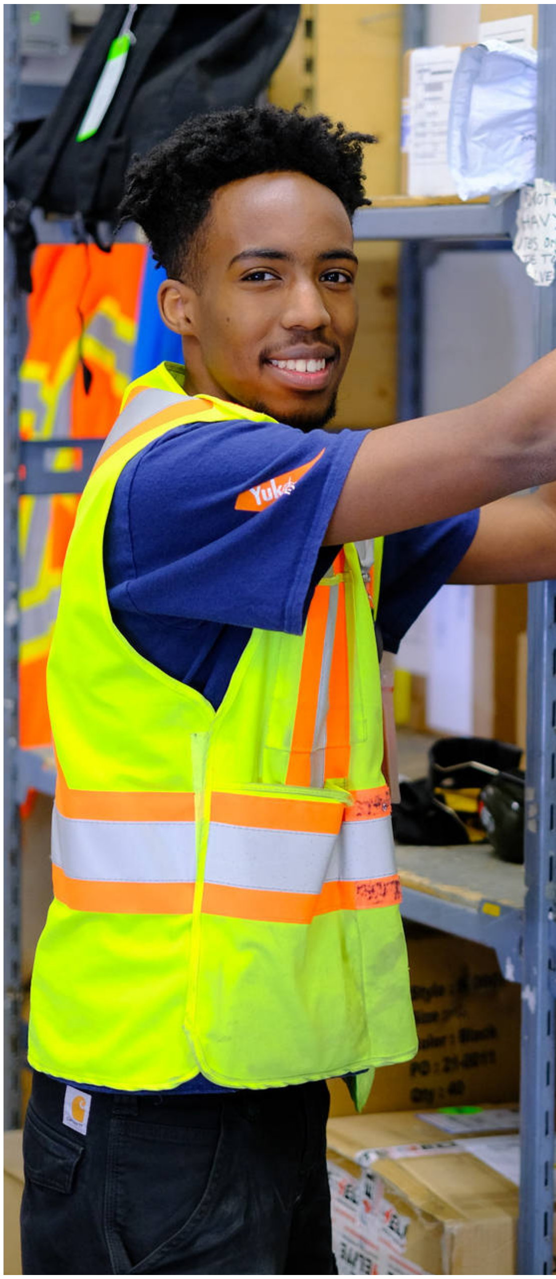
Competitive Dynamics

Competitive dynamics are another looming challenge. I have said throughout the COVID experience, that, in my opinion, we would have been better off with less cash and more leadership through policy. The COVID experience illustrated how regional air services are not unlike public utilities in the regions they serve, and there is plenty of data to show that much of the money spent on essential air service subsidy programs could have been replaced by focused policy. In my several papers directed to federal agencies, I observed that the apparent focus on competition would produce a scenario where the best option available to mainline carriers emerging from COVID would be to "pillage and plunder," which comes at the expense of regional carriers and regional communities. We are seeing some of that in our market.

As an aside, the element in this discussion that seems to be completely overlooked is environmental. Aviation easily exceeded its environmental impact targets during COVID by simply not flying, and we should learn from that. We can achieve our environmental-impact-reduction goals if we consume less and if we consume smarter. For airlines, capacity rationalization leads to less flying but more full flights and improved finances, which in turn facilitates the acquisition of modern, fuel-efficient aircraft. The math is simple and it is a complete win-win-win situation.

Getting back to the competition, our overall objective as we build back our schedule is not to grow our flying, but rather to get back to pre-pandemic flying volumes and to increase our competitiveness and sustainability by growing access to new destinations for our Yukon market. We hope to achieve this largely through interline agreements with key industry partners.

In the absence of full interline agreements with either mainline carrier, in order to compete for a larger share of the Yukon market, we need to fly to more places. I am pretty comfortable in saying that the Yukon, and in particular rural Yukoners, have never had better access to destinations outside our territory. This summer we have at least two daily flights to Vancouver, daily flights to Kelowna, Edmonton, and Calgary, service to Victoria four days per week, Yellowknife three days per week, Toronto twice weekly, and Ottawa once per week. Our north sked operates daily and Dawson has two flights per day at least three days out of the week. Same-day connections are often possible between southern cities and Dawson City or Old Crow, and also between Yellowknife and Vancouver.



Our "connection focused" schedule is generating increased connecting bookings because of our enhanced booking capability with brick-and-mortar and online travel agencies, tour operators, and because of our growing list of interline partners—mainline carriers excepted. This has allowed us to grow our share of the Yukon market from 64% in 2019 to almost 85% through June 2022, and our success in this regard keeps money in our economy, provides employment for Yukoners, and provides great service and fair pricing for Yukoners and for visitors to the Yukon.

Our market share growth has apparently caught the eye of our competitors, who are likely sensitive to their diminished ability to extract wealth from the territory. Whitehorse has the distinction of being one of only eight Canadian cities receiving service from Vancouver with the 169 seat Boeing 737 Max 8 aircraft, and the only city with a population of less than 400,000 (see opposite). With respect to airfares, in April, our competitor was charging $335, on average, to fly from Whitehorse to Vancouver. In June, they are averaging $168.

The irony of this dynamic is that both carriers and the travelling public, including and especially residents of regional communities, would clearly be better off through an interline agreement. This would lead to capacity rationalization and enhanced sustainability for both airlines. Any traffic loss through their reduced capacity on the primary gateway routes would be more than offset by traffic gains through our reduced capacity on the secondary gateway routes. Whichever mainline carrier figures this out first will have a distinct leg up on their competitor.

Air Canada Boeing 737 Max 8 Routes from Vancouver
Summer 2022

City	Population
Mexico City	8,855,000
Los Angeles	3,973,000
Toronto	2,930,000
Montreal	1,780,000
Phoenix	1,658,000
Calgary	1,336,000
Ottawa	994,837
Edmonton	981,280
Austin	965,872
Cancun	888,797
San Francisco	874,784
Winnipeg	749,534
Denver	715,878
Nashville	692,587
Boston	689,326
Halifax	439,819
Honolulu	347,181
Anchorage	292,900
Puerta Vallarta	291,839
Newark	281,917
Maui	164,754
Whitehorse	25,085

Labour Shortages

The labour market is becoming a bigger challenge every day, to the point where our current peak season summer schedule is limited more by our ability to operate flights than by our ability to fill aircraft. We are currently forced to cap or consolidate some flights due to both aircrew shortages and support staff shortages. We have recently had to make arrangements to sub-contract some of our flying and have also been approached by at least two other carriers to sub-contract for them. I have heard, anecdotally, of significant cancellations in mainline networks as well—so the shortage is real!

With respect to aircrews, the most acute shortages are in the flight attendant department, and with respect to support staff, the most acute shortages are passenger service agents and call centre agents. We have been actively recruiting to fill vacant positions and as of this month, we have been able to increase our total Full Time Equivalent employees (FTEs) from 200 to 259, and our Yukon FTEs from 173 to 226. Our Yukon FTE count is another illustration of the value to our economy and our community of being the "hub" rather than the "spoke."

Fleet Modernization

Our next major capital project is the modernization of our jet fleet. Although COVID put this on the shelf temporarily, we are back in discussions with aircraft manufacturers and vendors. This will represent the largest capital project in our history, and it will produce significant environmental and other savings.

Maintaining Peak Season Operational Integrity

The foregoing discussion displays a fair bit of "doom and gloom" for the airline industry. It's pretty safe to say with rising fuel prices, rising interest rates, rampant inflation, a hyper-competitive market and a tough labour market, this is not a great time for growth, expansion, or fleet renewal. Having said that, one cannot sit still in this business. We are doing a great job of getting record numbers of people to fly with us instead of the other guys, and it would be a real shame to give back these gains by allowing the big guys to recapture or grow their presence in our backyard—so the next two months are critical.

I appreciate and am thankful for just how hard everyone has been working this summer. All of you have been doing a phenomenal job of keeping our passengers moving despite the challenges we, and the industry as a whole, have been facing. To date we have managed to avoid the huge corrections our competitors have had to do, which has been better for our customers. We have made some adjustments to our schedule and have entered into a short-term contract to cover some flights that we currently do not have staff to cover—but ultimately our success over the next couple of months will still rely on all of you to continue performing above and beyond.

If we are able to achieve full performance across all of our departments, which may include some of you forgoing some vacation time or taking on extra shifts, a profitable June, July, August and September will allow us to offer a special "summer profit distribution." Although we still expect to lose money in 2022 even if those months are profitable, the management team feel it is critical, if we can, to offer some additional recognition for your work. We should all take a lot of pride in the resilience and determination that every department has shown this summer. Operating an airline as admired as Air North requires a remarkable team and effort, especially in the current environment.

Thank you, once again, for all your hard work and support.

Joseph Sparling, PRESIDENT
AIR NORTH, YUKON'S AIRLINE

2020 Travellers' Choice Tripadvisor

Best Airline
Canada

Best Specialty Airline
North America