AIR CANADA

News Releases

Mittleman Brothers, LLC Open Letter to the Board of Directors of Aimia Inc.

NEW YORK, Aug. 6, 2018 /CNW/ --

Board of Directors
Aimia Inc.
525 Avenue Viger West, Suite 1000
Montreal, QC H2Z 0B2
Canada

Re: Recent offers for Aeroplan and PLM

Dear Sirs and Madam:

As the Chief Investment Officer for Mittleman Brothers, LLC, which is Aimia Inc.'s largest shareholder with a 17.6% stake, I feel compelled to share my opinion of the offer for Aeroplan announced on July 25th (revised and expired Aug. 2nd), and the offer for PLM announced on July 26th (wisely rejected by you on same day). The views expressed here are mine alone, but I've had unsolicited calls from many shareholders since July 25th, with estimated ownership of 20% of Aimia's stock, who related opinions on these matters that largely concur with my own views.

I share my convictions with you publicly now so that all interested parties may have a more complete understanding of the expectations on valuation of a large number of Aimia's owners. I do not purport to speak for the Board or any director, and I don't intend to interfere in your process, nor do I attempt to instruct or demand any action on your part. I merely mean to inform in hope of assisting you in achieving the best outcome for all of Aimia's stakeholders.

In my opinion, the offer for Aeroplan from the Air Canada-TD-CIBC-Visa consortium was misleading, coercive, and blatantly inadequate. I applaud the Board for not acquiescing and continuing negotiations. But, if fair value is not forthcoming from this group, then let Aeroplan pursue the strategy that Aimia's new CEO, Jeremy Rabe, previewed so convincingly on July 20th, which appears to be a major improvement upon the existing Aeroplan program, and a huge relief to concerned members. The potential deal with the Oneworld airline alliance (American Airlines, British Airways, Qantas, JAL, and LATAM among others) revealed on Aug. 1st, and the Porter Airlines deal announced Aug. 3rd, would clearly boost the value of Aeroplan beyond 2020.

The offer was misleading in that it claimed that the C$250M cash offer (raised to C$325M) for Aeroplan equated to a C$2.25B (C$2.325B) total purchase price due to the assumption of approximately C$2B of Aeroplan's points liability. But, that deferred revenue is a negative working capital benefit that renews and rolls over as long as the business remains a going concern. I can find no precedent where it was treated as a charge to enterprise value in similar M&A transactions. It is disingenuous for the consortium to argue otherwise, and misleading to conflate it with the purchase value in this offer. Also, the stated cash value of the offer itself would have been severely reduced by various adjustments, leaving little net cash paid to Aimia for selling one of the world's largest and most successful coalition loyalty programs.

When Air Canada bought Canadian Air in December 1999, the enterprise value was C$937M, consisting of C$92M in equity, C$59M in preferred equity, and C$786M in debt, with no mention or monetary allowance for the 3M members of Canadian Air's frequent flyer program, "Canadian Plus," and its sizable points liability. The liability was assumed, and the points were honored 1-for-1 with Aeroplan points, but the points liability was not mentioned or considered as extra consideration to the seller. Aeroplan membership grew from 2M to 5M in that deal.

When American Airlines Group bought US Airways Group in 2013, the fairness opinion provided by Barclays did not adjust enterprise value or consider in any way the US$1.12B in frequent flyer miles liability of U.S. Airways' "Dividend Miles" program and its 30M members. Nor did Barclays consider such liabilities in establishing the enterprise values of their chosen comparables group. These liabilities are identified from an accounting perspective, but they are assumed much as any naturally occurring negative working capital balance would be, without claiming the assumption should be considered incremental merger consideration to the seller.

On January 27, 2003 Onex Corp., led by the legendary investor Gerry Schwartz, announced a deal to buy 35% of Aeroplan from

Air Canada, for C$245M, an equity valuation of C$700M, plus C$200M in retained debt, which made the enterprise value C$900M. Gerry Schwartz said then, "We view Aeroplan as the gem within Air Canada..." No mention of the points liability was made in that announcement, nor considered in the stated C$900M enterprise value. Furthermore, that valuation was 1.5x Aeroplan's gross billings of C$600 in 2002, 40% of which came from Air Canada. Adjusted EBITDA was C$108M in 2003, a 17.3% EBITDA margin on C$625M in gross billings that year, and thus a C$900M EV was 8.3x EBITDA. That deal did not close because Air Canada went bankrupt shortly after the deal was announced.

Aimia's most recently reaffirmed guidance (page 39 of Q2 2018 results presentation) for Aeroplan shows C$1.3B gross billings, adjusted EBITDA of C$234M (18% EBITDA margin), after-tax FCF of just over C$100M, with Air Canada representing 20% of gross billings (versus 40% back in 2003). At the same multiples Onex Corp. agreed to pay when Aeroplan was twice as dependent upon Air Canada in 2003, 1.5x gross billings and 8.3x EBITDA, Aeroplan today would be valued at C$1.94B, vs. the very soft C$325M last offered.

When Aeroplan (now Aimia Inc.) IPO'd on June 29, 2005, with ACE Aviation Holdings (former parent of Air Canada) selling 28.75M shares of Aimia at C$10.00 per share, the enterprise value was C$2B, which was a fairly rich valuation of 15x EBITDA of C$132M (TTM). If the C$863M in points liability then was also tacked on to the enterprise value, it would have been 22x EBITDA. And two secondary offerings, 22M shares at C$21.90 on 10/22/07, and 20.4M shares at C$17.50 on 4/21/08, combined to raise C$930M at very high valuations, along with C$1.68B in Aimia shares distributed to ACE shareholders in 2007, means Air Canada's former parent reaped C$2.61B from their investment in Aeroplan before considering cash dividends received, which were substantial. And later when Air Canada was skirting near the brink of a second bankruptcy in 2009, Aimia provided a critical C$150M loan to help Air Canada avoid that fate. Aeroplan has been an outstanding partner to Air Canada.

In October 1999, CIBC paid Air Canada C$200M to extend their participation in Aeroplan for another 10 years until 2009. C$200M, not to buy out the entirety of Aeroplan, just to maintain their participation in it for another 10 years. Then in 2003, despite Air Canada being in bankruptcy, CIBC apparently saw demand and earnings on its co-branded Aeroplan Visa cards good enough to agree to pay 19% more for rewards miles and advance C$350M to Air Canada to assist in its reorganization. Presumably Aeroplan members will find multiple airline redemption options in 2020 at least as appealing as they found a bankrupt Air Canada in 2003.

At the nominal valuation of the most recent offer, C$325M, the multiple is 1.4x EBITDA (C$234M guidance for 2018 in Q1 2018 presentation, page 32). And the consensus estimate for 2021 (as per Bloomberg) is C$136M, so only 2.4x EBITDA for the first full year on stand-alone basis, and 3.3x the C$100M EBITDA estimate I am using for 2021. And while reasonable people can have significant differences of opinion on the inherently subjective matter of valuation, I think 1.4x to 3.3x EBITDA is clearly beyond the bounds of any conceivable range of reasonableness for a business that has proven to be such a huge generator of cash for so many years, to the very parties seeking to buy it now, for a miniscule fraction of what they've already taken out of it.

Aeroplan is the lynchpin in the nexus of this powerful network, where TD, CIBC, Visa, Amex, and Air Canada generate hundreds of millions in net profits annually from their Aeroplan card holders. Before TD bought roughly half of CIBC's Aeroplan-linked credit cards in late 2013, CIBC reported that its Aeroplan cards produced C$380M in net profit in the 12 months ending 7/31/13, 12% of overall profits. Given consumer credit in Canada is up about 20% since then, one could easily infer that those cards (now split between TD & CIBC) generate north of C$450M in annual profits now. TD and CIBC trade at around 11x earnings now, so at that multiple of 11x those Aeroplan cards are worth about C$5B to just those two companies. I estimate that C$7B to C$10B in total value is at stake in preserving this economic ecosystem for all partners, for which Aimia could easily extract C$2B to allow it to be renewed and extended coincident with the cashing out of Aimia's ownership going forward. C$2B is less than 10x EBITDA for Aeroplan currently. I can find no example of a major coalition loyalty program changing hands for less than 10x EBITDA in the past 20 years; why should Aeroplan be the first? (the Onex deal for Aeroplan at 8.3x EBITDA in 2003 did not close, and was only offered so cheaply because Air Canada was in dire straits, and went bankrupt 3 months later.)

In writing to my clients about Aimia, I have used a very conservative value of C$1B for Aeroplan, which was quoted in the press recently. But that valuation is based on my most conservative estimate of C$100M in EBITDA post-2020 on a standalone basis, and not reflective of any control premium. The strategic value of Aeroplan is clearly much greater than its stand-alone value to Aimia. Thus, a compromise between what it's worth to Aimia, at certainly no less than C$1B, and what it's worth to the consortium, at C$2B+, seems reasonable. That is 4.3x to 8.6x EBITDA of C$234M currently, versus 10x to 20x EBITDA of C$100M in 2021 to a buyer other than Air Canada, and really less than 10x to 20x given the much higher EBITDA and FCF in the next 2 years would reduce the effective multiple significantly for the buyer closing in 2018.

If Aimia cannot obtain at least the stand-alone value of Aeroplan, C$1B, plus a modest control premium of 20%, then I'd prefer Aimia not sell it. Aimia has the resources to manage whatever likely cash burn may come, if any, during the transition period with current cash, bonds, and liquid securities worth C$616M on 6/30/18, at 32% of the points liability of C$1.957B, a healthy reserve ratio that will be further enhanced by C$200M in net after-tax FCF expected over the next two years, and the potential

sale of its 49% stake in PLM for a real multiple of no less than 10x EBITDA, which would be C$490M based on US$77M in EBITDA for 2017, which would bring the reserve ratio up to 66%. Aimia has functioned since 2005 with an average of C$400M in cash reserves earmarked for redemption liabilities, and the reserves were never touched. Even during the 2003 bankruptcy of Air Canada, there was no run on the bank. Aeroplan never had an annual period in which it burned cash then or thereafter. Of its current C$330M in debt, the C$250M in 6.85% senior secured notes due May 17, 2019 was $99.30 just before the consortium offer was announced, indicating no market concern about refinancing (current price $101.21).

Aimia's new CEO, Jeremy Rabe, is a proven executive in the loyalty arena and well-suited to run a major coalition loyalty program like Aeroplan. His strategy is clearly sound and already making progress. I believe Aeroplan in 2 years will be a more attractive program than it is today, and today it has got very high engagement as evidenced by its very low breakage rate, and a loyal and long-term user base. Aimia need not be entertaining offers for Aeroplan at 1.4x or 3.3x EBITDA, especially from partners to which it has provided such outstanding financial returns.

In matters of valuation there is always a degree of subjectivity on inputs, assumptions, multiples, margins, growth, discount rate, etc. But there are limits. And veering too far from those limits takes one into the realm of ridiculousness, and posturing. The Air Canada-TD-CIBC-Visa consortium bids for Aeroplan were deep into that realm at C$250M-C$325M; a "shock and awe" tactic designed to incite panic and anchor expectations to an absurd level. Rather than some of the biggest and best-known corporate entities in Canada, the consortium seems here more like a group of school yard bullies, trying to force a smaller kid to give them his bicycle, "give it up by 5:00PM next week, or we will dismantle it and take the parts to make a new one for ourselves."

Air Canada cannot on one hand claim that its non-existent loyalty program will have an NPV of C$2B, but then on the other hand claim that Aeroplan's well-established, FCF-generating, 5M member giant is worth less than C$1B. And for Air Canada to claim their offer was "generous" at a premium to the recent trading price, after they were much to blame for the recent low trading price given their May 11, 2017 announcement saw Aimia's share price drop 63% that day, is absurd, and the short fuse expiration of the offer, clearly coercive. Also, TD was called out by Aimia CFO Grafton on the Q1 2018 results conference call for significantly reducing promotional spending on the card since June 2017, apparently, as we now see, in advance of trying to buy Aeroplan on the cheap. While I'm not qualified to opine on questions of legality, the pattern of behaviors here is disconcerting to say the least. I hope that will change now.

Touching on PLM more briefly, the Board was right to reject it immediately, given the US$180M offer was obscenely low, a US$367M EV or 4.8x EBITDA of US$77M. The last time Aimia invested in PLM was 2012, when Aimia paid US$88M for an additional 20% stake at an EV of US$440M, an agreed upon 15% discount to the then agreed-upon valuation of US$518M for PLM. That valuation was based on a TTM gross billings number of US$115M for PLM from Oct. 2012, and adjusted EBITDA margin of 30%+, so at least US$35M in EBITDA. So, both parties agreed it was worth 14.8x EBITDA then, and Aimia paid 12.6x EBITDA to invest more into then, but now with EBITDA more than doubled since then, Aeromexico offers to buy PLM for only US$367M, or 4.8x EBITDA? And to cite that the management contract will expire in 2030 (12 years from now) as a pressure point was quizzical, as Aimia's 49% ownership in PLM does not have an expiration date. PLM has excellent growth prospects, I hope Aimia will hold it as long as possible.

Our sum of the parts valuation for Aimia is C$10.00 (USD 7.50), which is 2.7x today's price:

Aeroplan (Canada): ownership (100%), estimated min. fair value = C$1B, 4.3x C$234M EBITDA est. 2018, 10x C$100M EBITDA post 2020 = C$6.57 per share (ignores the C$2B miles redemption liability for purpose of enterprise valuation, as airlines don't charge frequent flyer liabilities to EV in their M&A transactions, viewing it as an ongoing negative working capital benefit as long as business is a going concern, and a substantially reduced cash cost in a liquidation / run-off scenario which we view as extremely unlikely.) Aeroplan likely has strategic value well above our C$1B minimum estimate in that its 5M+ members and its key commercial contracts occupy a critical role at the nexus of a very valuable economic ecosystem involving TD Bank, CIBC, Visa, Amex Canada, and Air Canada, which have hundreds of millions of annual profits at stake in preserving it.

PLM Premier (Mexico): ownership (48.9%), est. fair value = US$489M, 10x US$100M EBITDA est. 2019 = US$3.21 per share 5.7M members in fast growing coalition loyalty program anchored by Aeromexico, Mexico's flagship airline. Aimia invested US$124M for 48.9% stake between 2010-2012, and since then received US$84M in cash dividends. At last financing round in 2012, PLM total enterprise was valued at US$518M, and it has grown a lot since then. Comps: Smiles Fidelidade S.A. (SMLS3 BZ) and Multiplus S.A. (MPLU3 BZ) trade about 7x EBITDA, down sharply in emerging market sell-off, but fair value likely closer to 10x EBITDA for both.

Cardlytics (CDLX): ownership (2.978M shares), price on 6/30/18= $21.76 = USD 65M = US$0.43 per share
Think BIG Digital – Air Asia: (20%), est. fair value = USD 50M, US$16 x 16M members = US$0.33 per share
Fractal Analytics (USA): (5%), est. fair value = US$18M (5% of $360M (=6x $60M sales) = US$0.12 per share

Assets (excluding cash) = C$1.817B = C$11.93 / US$9.07 per share

(+ cash & bonds C$531M – C$45M working cap. need– C$330M debt – C$43M pension deficit – C$323M preferred – C$34M accrued interest) = -C$244M

NAV: = C$1.573B / US$1.201B / 152.3M shares = C$10.33 / US$7.88 per share (CAD/USD = 1.31 as of 6/30/18)

I can only advise the Board, not dictate to it, but I hope I've shown here that it is obvious that Aimia should not accept less than C$1B net for its core asset, especially not with a gun held to its head by its key commercial partners, for whom Aeroplan has been such a tremendously productive partner for so many years. Gerry Schwartz of Onex was clearly right to describe Aeroplan as "the gem within Air Canada" when he tried to buy 35% of Aeroplan back in 2003 at 8.3x EBITDA. For the 12 years from 2006 to 2017 inclusive, Air Canada had a cumulative C$3.5B in cash burn (negative FCF), while Aimia (mostly due to Aeroplan) generated a cumulative C$2.8B in FCF over those same 12 years, both stats according to Bloomberg. If Air Canada wants to buy back this gem that they sold from 2005 to 2008 for more than 15x EBITDA (and cumulative proceeds of $2.6B), they should expect to pay a fair price. Since Aeroplan is clearly a superior business, it cannot be worth less than the valuation at which Air Canada itself trades today in the open market, which at C$23.73, is an EV/EBITDA of 5x (adding pension liability), and market cap. to FCF of 11x. Aeroplan at those multiples would be about C$1.2B.

I hope you find my ideas here useful. On behalf of all Aimia shareholders, I wish you good luck.

Sincerely,

Christopher P. Mittleman
Chief Investment Officer - Managing Partner
Mittleman Brothers, LLC

View original content:http://www.prnewswire.com/news-releases/mittleman-brothers-llc-open-letter-to-the-board-of-directors-of-aimia-inc-300692437.html

SOURCE Mittleman Brothers, LLC

For further information: Investor Relations, info@mittlemanbrothers.com, 212-217-2340, http://www.mittlemanbrothers.com

A STAR ALLIANCE MEMBER