VERITAS INVESTMENT RESEARCH

Aimia Inc.
SELL– C$0.75

Ticker	Current Price
TSX-AIM	C$2.78

FLASH

Kathleen Wong
kwong@veritascorp.com

SELLING NECTAR: AIMIA'S PROSPECTS NARROW AS 2020 LOOMS

Aimia announced yesterday that it has sold the Nectar program and related assets[1] to J Sainsbury plc ("Sainsbury") for $105 million cash. However, Aimia has to pay Sainsbury $183 million to cover future redemption cost liability at the Nectar program, representing accumulated and unbroken Nectar points that have not yet been redeemed.

This transaction once again highlights the risks facing Aimia's business model ex-Air Canada – accumulated redemption cost liabilities, which exceed $2.0 billion at Aeroplan, are no longer matched against the same level of new billings. These liabilities must be deducted in calculating the net worth of Aeroplan. Despite Aimia's business as usual operations in 2017, which still generate cash flows, this cash is far less than the post-2020 liabilities the company will have when Air Canada ends its Aeroplan relationship in June 2020. Moreover, the Nectar deal highlights that potential acquirers of Aimia will want to be compensated for taking on Aeroplan's $2 billion future redemption cost liability, which may leave very little for current Aimia shareholders.

IMPLICATIONS OF NECTAR'S SALE

Our review of Aimia's deal for Nectar and its related assets suggests the following implications:

- **Nectar's implied takeout multiple is 0.3x gross billings less working capital, much lower than the 1.0x gross billings Aimia paid to buy Loyalty Management Group in 2007:** Based on YTD financials, we estimate Nectar's annual gross billings to be ~$400 million, therefore, the implied takeout multiple would be 0.26x gross billings. We think the takeout multiple provides a benchmark in terms of what the remaining assets in the international coalition might be worth. Aimia bought Loyalty Marketing Group (including Nectar) in 2007 for $715 million and the value was subsequently written down to $396 million. At the written down value, Aimia's implied acquisition multiple represent was ~1x the gross billings generated in Europe and Middle East in 2008 (also about $395 million).

- **Don't forget to value future redemption cost liability – Aeroplan's future redemption cost liability is now over $2.0 billion:** Nectar's already low selling price is effectively reduced by a required a cash transfer to cover redemption liabilities. **We estimate that Aeroplan's future redemption liability is now ~$2.1 billion.** In our view, this liability has to be deducted in any calculations of Aimia's net worth.

Unfortunately, we think Nectar's disposal for little or negative considerations should be seen as a red flag for valuations of Aimia's other partnerships and assets, if not the company's liability-heavy core business. After updating our valuation for Nectar's sale, we now see Aimia as worth $0.75 per share, down from $0.90. Aimia remains a SELL.

[1] *The Nectar sale includes the loyalty business, employees, assets and liabilities, systems, licenses and trademarks. Shoppers Insights & Communications U.K., including Aimia's Intelligent Research business and 50% equity stake in i2c. Aimia's legacy Shopper Insights platform (self-serve) will be licensed back to Aimia on a royalty fee basis.*

UPDATING AIMIA'S VALUATION FOR NECTAR'S SALE

We have updated our valuation model for Aimia with the following changes:

1. **An updated value of Aeroplan's future redemption cost liability:** We have increased our estimate of Aeroplan's future redemption cost liability to $2.075 billion based on Q3-2017 disclosures and the announced transfer of Nectar's future redemption cost liability.

2. **The cash transfer of $183 million to Sainsbury to cover Nectar's future redemption cost liablity:** We note, however, that this cash is part of a net transfer Nectar-related working capital totaling $96 million (receivables, payables, etc.).

3. **An update for our 2017 estimate of American Coalition gross billings**: We have increased our 2017 gross billings assumptions in the American Coalitions segment to $1,263 million (up from $1,223 million) based on the nine months gross billings reported by Aimia.

4. **The addition of $105 million in gross proceeds from sale of Nectar, $100 million of which will pay down debt:** We have reduced the long-term debt outstanding as at September 30, 2017 by $100 million to $349 million due to the planned use of proceeds from the sale of the Nectar program to pay down debt.

5. **Our revised valuation estimate for the remaining assets in the International Coalition segment of ~$38 million:** We had previously assumed the international coalition segment was worth ~$250 million (including Nectar). Excluding the Nectar program and the related assets sold to Sainsbury, Aimia is retaining the following businesses in the International Coalitions segment:

   - Air Miles Middle East business and Air Miles international trademark
   - Middle East Loyalty Solutions
   - Shoppers Insights & Communications International (including Intelligent Shopper Solutions and next generation Shopper Insights Platform (AIP)
   - GLS presence and corporate functions based in the U.K.

   We estimate the gross billings from loyalty services in the International Coalition segment will be $75 million in 2017. Assuming a 0.5x multiple of gross billings, we estimate these remaining businesses could fetch ~$38 million.

6. **An updated FCF estimate for the period prior to Air Canada's exit (Q4-2017 to June 2020):** Previously, we had conservatively assumed no free cash for Aimia's Aeroplan business to account for the risk that members could trigger a 'run on the miles' leading to negative free cash flows in the later stages leading up to June 2020. We now see a diminished risk of this outcome, with Aimia likely to generate positive free cash flows for this stub period. As shown in Figure 1, Aimia's trailing-twelve-month-free cash flow (FCF) totals $98 million and we expect the company to generate ~$173 from Q4-2017 to 2020. For 2018, FCF falls by the $60 million being generated by Nectar, to our estimate of ~$83 million:

Figure 1
Our FCF estimates for the period Q4-2017 to June 2020
Amounts in millions of Canadian dollars

	Q1-Q3, 2017	Q4-2017	2017E	2018E	2019E	2020	Q4-2017 to 2020
Aimia FCF	$98	$45	$143	$83	$45	$0	$173

Source: Veritas estimates

7. **Our updated valuation of Club Premier at $508 million:** Club Premier operates the frequent flyer program (FFP) for Mexico's largest airline, Aeromexico, which is the leading coalition program in Mexico. In 2010, Aeromexico partnered with Aimia to accelerate the development of its FFP, forming Premier Loyalty & Marketing ("PLM"), which owns and operates Club Premier. Aimia currently has a 48.9% stake in PLM Premier and Aeromexico owns the remaining 51.1% interest.

Valuing Club Premier based on the average Enterprise Value (EV) per Member of its peers (US$157 per member) and 5.3 million Club Premier members, implies a value of US$831 million for PLM (Figure 2). Therefore, Aimia's 48.9% stake would be valued at ~$508 million in Canadian dollars based on a C$1.25/USD exchange rate.

Figure 2

Frequent Flyer Peers Valuation

Amounts in millions of U.S. dollars, except as noted

Frequent Flyer Program - Current Peers Valuation	Latest Number of Members	Enterprise Value ($US)	EV/Member ($US)	LTM Gross Billings (US$)	EV/LTM Gross Billing ($US)
Smiles	12.8	$3,088	**$241**	$568	**5.4x**
Multiplus	18.7	$1,363	$73	$733	1.9x
Weighted Average	**16.3**	**$2,560**	**$157**	**$661**	**3.9x**

Source: Company reports, Veritas estimates

Below, we present our updated valuation estimate for Aimia included our list of changes:

Figure 3

Post-2020 Aimia Valuation: Assuming Stable Miles Outstanding and Loss of Air Canada with No Replacement

Amounts in millions of Canadian dollars

Net Redemption Liabilities	June 2020	Per share*
Future Redemption Cost Liability at Sep. 30, 2017, reduced by Nectar future redemption cost liability of $178 M	(2,075)	
Cash at Sep. 30, 2017	374.8	
Restricted cash at Sep. 30, 2017	20.3	
Short-term investment at Sep. 30, 2017	89.6	
Long-term investment (corporate and government bonds) at Sep. 30, 2017	183.9	
Long-term investment (equity investment)at Sep. 30, 2017	115.9	
Equity accounted investment in joint venture , excluding Club Premier at Sep. 30, 2017	19.6	
Cash transfer to Sainsbury to pay for Nectar future redemption cost liability	(183)	
A) Subtotal: Future redemption liabilities net of cash and investments	**(1,454)**	**($9.54)**
Post-2020 American Coalitions Valuation, before Net Redemption Liabilities		
**** Post 2020 American Coalitions Gross Billings, 20% of non-Air Canada retained ($1,263M-$262M) x 20%**	**200**	
Post-2020 American Coalitions redemption costs, 70% of flight redemption costs increased by 25%	(167)	
Subtotal: American Coalitions Spread, assuming decline from 29% to 16.4% of gross billings	**33**	
American Coalition – loyalty services business gross billings ($100M-$30M)	70	
Operating expenses, assumed at 10% of American Coalition gross billings	(36)	
Subtotal: Annual FCF for post-2020 American Coalitions business	**67**	
B) Valuation of post-2020 American Coalitions business at 15.0x free cash flow	**1,002**	**$6.57**
Summary of Aimia Equity Value		
A) Subtotal: Future redemption cost liability net of cash and investments	**(1,454)**	
B) Valuation of post-2020 American Coalitions at 15.0x free cash flow	**1,002**	
Long-term debt $450M at Sep. 30, 2017	(449)	
Debt repayment using proceeds from the sale of Nectar	100	
Preferred shares $322.5M at Sep. 30, 2017	(323)	
Value of remaining International Coalitions excluding Nectar and related assets, $75M gross billings at 0.5x	38	
**** Interim free cash flows from Sept. 2017 to June 2020**	**173**	
**** Est. market value of 48.9% interest in PLM (Club Premier)**	**508**	
**** 25% devaluation of 2020 Aeroplan miles (fixed grid repricing), redemption liability falls $2.0B x 25%**	**519**	
Value of Aimia's equity	**114**	**$0.75**

** 152.4 million shares outstanding.*

*** Critical assumptions supporting a positive value for Aimia's equity.*

Source: Company disclosures, Veritas estimates

Note that, in our calculations, Aimia is only able to retain positive equity value of $0.75 per share because of four key assumptions:

1) 20% of non-Air Canada gross billings are retained post-2020.

2) Aimia achieves positive free cash flows through 2020. This requires that there be no significant run on Aeroplan's miles between now and then.

3) The PLM stake is achieves its full market value (i.e. PLM is not unloaded in the same manner as Nectar).

4) Aimia devalues its post-2020 miles by at least 25%.

In our view, each of these assumptions gives Aimia's shares the benefit of the doubt. Even then, at $0.75 per share, Aimia's equity value is well below its current share price. Given the risks, we remain sellers of this name.