



## **RESEARCH OPINION**

May 11, 2006

**PRIVILEGED & CONFIDENTIAL**

### **Independent Research Opinion regarding ACE Aviation First Quarter 2006**

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#### **ACE Aviation (TSX: ACE.B)**

##### **1. Closing the Gap: ACE Aviation versus WestJet Airlines**

Per the charts embedded in Appendix 'A' of this report, it is quite evident that the Operating Income/Loss per Available Seat Mile ("ASM") between ACE and WestJet Airlines has steadily been closing over the past several years.

Going back to 2003, WestJet enjoyed a considerable gap over Air Canada in its operating income per ASM. It was April 3<sup>rd</sup> of that year in which Air Canada filed for bankruptcy protection under the Companies' Creditors Arrangement Act ("CCAA").

With the exception of the past two Quarters, since 2003 ACE cost cutting and upward cost pressure at WestJet – as the latter carrier evolved from a pure play low-cost carrier – plus continuing strong Yield results at ACE, have collectively narrowed the gap.

Over the past two quarters, Q4-2005 and Q1-2006, the gap has again widened between the two carriers in favour of WestJet. In the 4<sup>th</sup> quarter of 2005, strong Yield and Revenue per ASM ("RASM") results at WestJet more than outstripped its 14.5% growth in Cost per ASM ("CASM") on a quarter-over-quarter basis. On the other hand, while ACE posted growth in Yield and RASM, they were not enough to outstrip its 8.1% growth in CASM.

Moving to the figures just released for the 1<sup>st</sup> quarter of 2006, ACE saw Yield rise 9.1% to 17.9 cents, and RASM rise 8.3% to 17.4 cents. However, revenue growth was not sufficient enough to offset the growth in CASM, which rose 10.5% to 17.8 cents. As a special note, excluding Aircraft Fuel, ACE would have seen its CASM rise by a much lower figure of 5.3%.

On the other side of the country, WestJet earlier reported a 7.8% rise in its CASM for the 1<sup>st</sup> quarter of 2006 to 12.5%. That rise in unit costs, however, was more than offset by a 18.8% rise in Yield to 13.7 cents, and a 28.2% rise in RASM to 10.9 cents. Quite evidently, WestJet's attempts to penetrate the central Canada market, the corporate sector, and travel agency community are having positive effects and positively affecting its profit margins relative to ACE.

*Note to the above data: (1) All CASM figures include Aircraft Fuel and (for ACE) special labour charges; (2) WestJet reports Yield as Operating Revenue over ASMs while ACE reports Yield as Passenger Revenue over ASMs. AirTrav has valued WestJet Yield per the ACE measurement.*

## **2. Forecast Valuation & Potential IPO – Air Canada Mainline**

AirTrav has considered the potential spin-off of Air Canada mainline operations from ACE Aviation. Based on this possibility, we have examined both the potential valuation of AC Mainline, and the potential shape of an Initial Public Offering.

### **(a) Valuation**

To determine the valuation of AC Mainline, we looked at ACE minus its ambient components. We took estimated valuations of ACTS and ACV, plus market worth and public holdings of Aeroplan and Jazz. Backing these out, this analysis puts AC Mainline at a standalone value of \$1.9-billion CAD. This figure is in the range of Canadian stock market analysts, including the \$2.0-billion figure quoted by Jacques Kafavian of Research Capital.

### **(b) Initial Public Offering Scenario:**

AirTrav believes the following represents a feasible IPO scenario:

- Total treasury shares: 100-million
- Percent of AC to be spun-off: 20%
- IPO shares: 20-million
- Price per Share: \$20
- AC company valuation: \$2-billion CAD
- IPO valuation: \$400-million CAD

Per AIRTRAV INC.

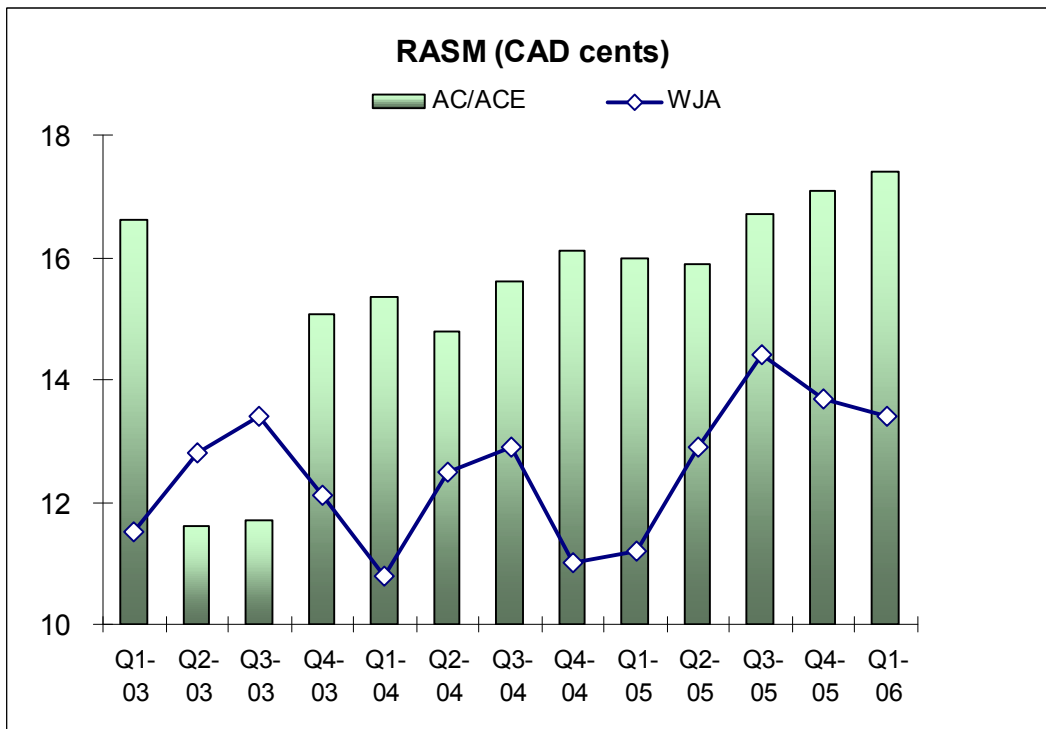
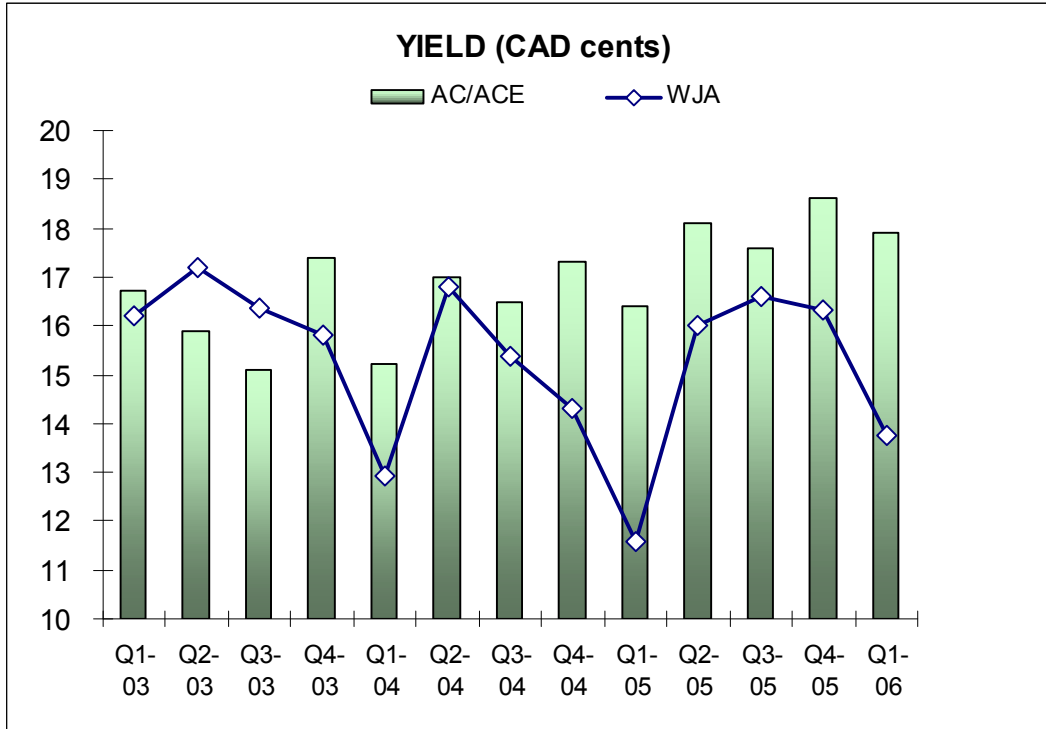
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**Appendix 'A'**



**Appendix 'A' / cont'd**

