

# ACE takes flight on spinoff talk: Investors cheer possible Air Canada IPO

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Shares of Air Canada parent ACE Aviation Holdings Inc. rose 6% yesterday after chief executive Robert Milton revisited the possibility of spinning off Air Canada in a bid to surface hidden value.

Mr. Milton reiterated comments he made in February about the possibility of spinning out Air Canada as a separate company, similar to the way ACE partially divested its loyalty program Aeroplan and regional carrier Jazz through income trust IPOs.

Investors reacted to the remarks, quoted in a report published yesterday, by pushing up ACE's shares \$1.92 to close at \$34.47 on the Toronto Stock Exchange.

"The idea is for ACE to become a true holding company," said **Peter Holden**, an analyst at **Veritas Investment Research**.

"It would own pieces of Air Canada, Jazz, Aeroplan and Air Canada Technical Services."

He said the problem with the current situation, in which ACE owns all of Air Canada, is that the airline tends to suffer from a holding company discount, which essentially represents the risk that investors attach to the fact there is an extra layer between them and the businesses in which they are investing.

While Mr. Milton did not set a timeline for an Air Canada IPO, his remarks suggest that he shares some analysts' concerns that Air Canada's core airline operations, estimated to account for the majority of ACE's revenue, are not receiving any valuation at all within ACE's stock.

Merrill Lynch analyst Michael Linenberg said in March that a sum-of-the-parts evaluation of ACE's non-core businesses reveals "the market is valuing the remainder of the company, which is principally Air Canada, at less than zero."

**Mr. Holden** believes that ACE should be trading around the \$50 mark.

"There's no question in my mind that Air Canada is undervalued and that if you spin it off some of that value will be realized."

Critics, however, questioned whether Air Canada can truly be divested given the fact that it is ACE's core operation and the business on which all of ACE's other subsidiaries are dependent.

"It's a great thing to muse about and it's a great way to get your stock up, but I'm not really sure how realistic this is," said one analyst, who didn't want his name used.

There's also the question of investor demand for a pure-play Air Canada stock.

Despite its extensive restructuring, Air Canada is still saddled with a higher cost structure than its main competitor, WestJet Airlines Ltd., and is seeing its margins squeezed by record high fuel prices.

It's also worth noting that ACE's most recent spinoff -- Jazz Air Income Fund -- has traded below its \$10 issue price for several months despite the fact that ACE tried to pass most of the volatility associated with the airline industry along to Air Canada, which has agreed to purchase a minimum level of capacity on the regional carrier each month.

Air Canada, by contrast, would come with no such guarantees.

ACE Aviation is scheduled to report its first-quarter earnings today, with average analysts' estimates forecasting a loss of 75 cents a share.