BLACK BEAR
VALUE PARTNERS

AIRLINES: VALUATION SUFFERING FROM SHINY OBJECT SYNDROME

June 2019

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INTRODUCTION TO BLACK BEAR VALUE PARTNERS, LP

"An investment in knowledge pays the best interest." – Benjamin Franklin

Overview

- Black Bear Value Partners is an a fundamental and value-oriented investment manager approach highlighted by certain attributes:
  - Preservation of capital
  - Understandable ideas
  - High margin of safety
  - Contrarian approach
  - Concentrated portfolio
  - Industry and asset class agnostic

Investment Philosophy

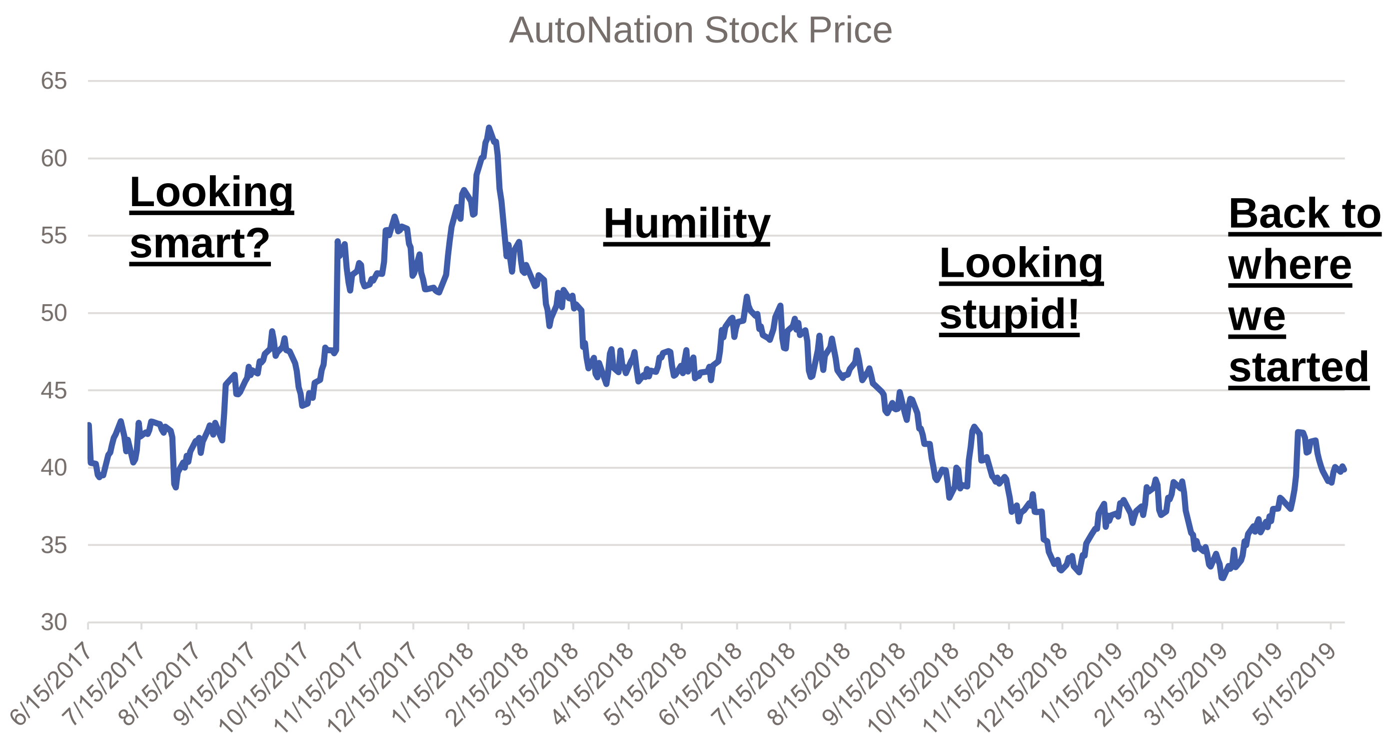
- Lower fees
- Significant personal investment
- Invest with a margin of safety
- Capital preservation is critical
- Performance driven culture
- Longer term capital base
- Patience and disciplined capital allocation

Portfolio Manager

- Led by Adam Schwartz, a 16 year professional buy-side investment analyst with extensive experience across a wide range of asset classes and investment themes including equities, structured credit, corporate credit, capital structure arbitrage and real estate
- Adam was a senior member of the investment team and a Director at Fir Tree Partners, a $13BB AUM investment manager from 2007-2015

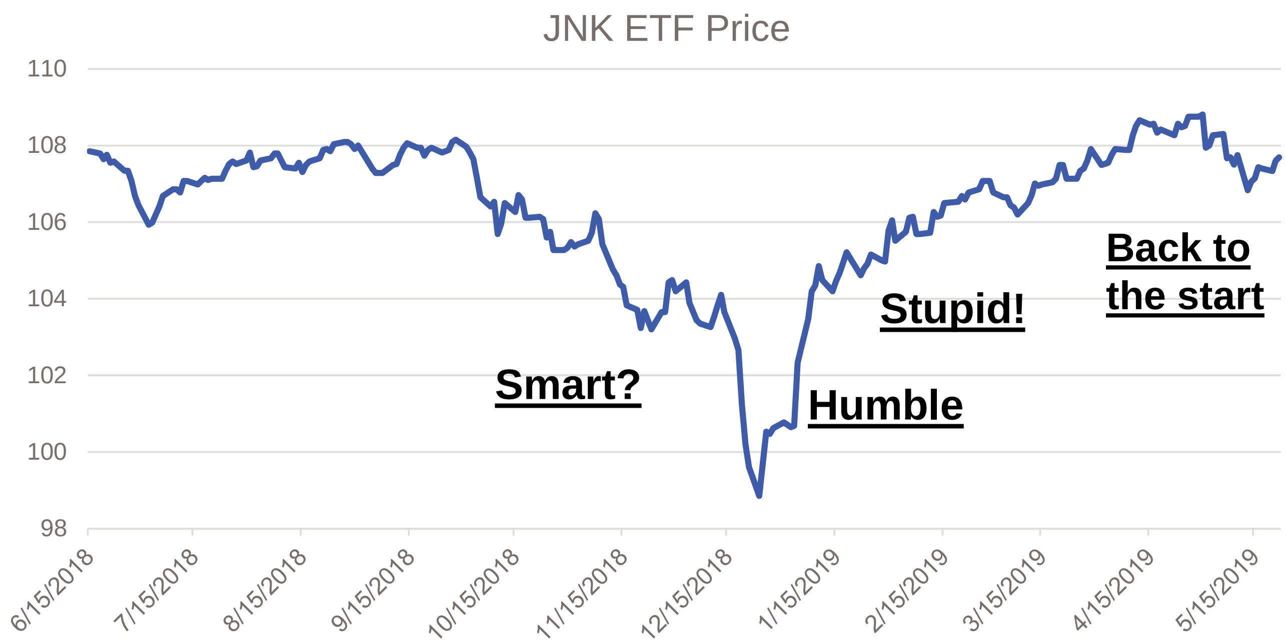
PAST IDEAS @ VALUEX VAIL
STAGES OF INVESTMENT AND PERSONAL GROWTH

- Long Auto Dealers – June 2017 (AutoNation)



PAST IDEAS @ VALUEX VAIL
STAGES OF INVESTMENT AND PERSONAL GROWTH

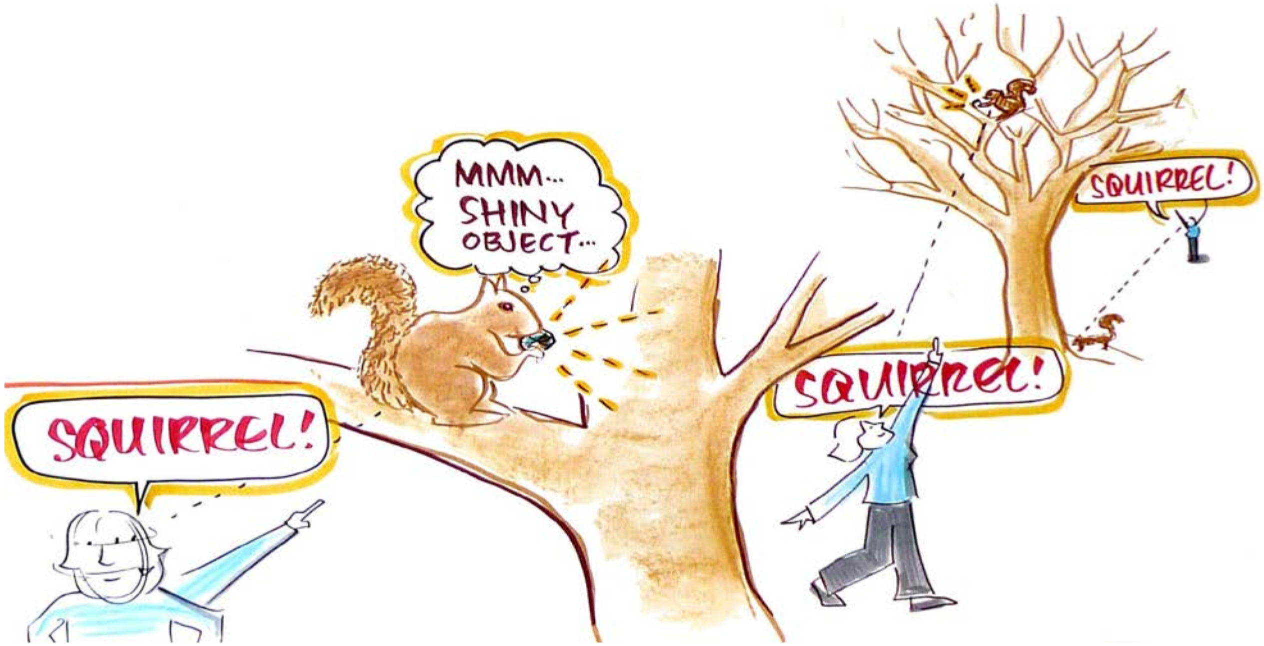
- Short Credit ETF's – June 2018



AIRLINES - WHY INVESTORS AVOID THEM

- Lots of bankruptcies & failures
- Highly competitive/commoditized
- Capital intensive
- Cyclical
- Historically poor balance sheets
- Historically bad capital allocators – "See Clouds…Buy Planes!"
- "If you want to be a millionaire, start with a billion dollars and launch a new airline." – Sir Richard Branson
- "In another context, a friend once asked me: "If you're so rich, why aren't you smart?' After reviewing my sorry performance with USAir, you may conclude he had a point." – Warren Buffett
- **Why buy an airline?**

AIRLINES – WHAT IS SHINY OBJECT SYNDROME



1. Headline businesses with hard to predict & frequent short-term data

2. Lots of sellside coverage focusing on these short-term variables

3. “Second” businesses with stickier and less capital-intensive cashflow

AIRLINES – WHAT IS SHINY OBJECT SYNDROME

PLANES AKA THE SHINY OBJECT

- Operating margins 5-20%
- ROIC 10+%
- More rational/duopolistic in certain hubs
- Demographic tailwinds
- High fixed costs
- GDP-tied/cyclical business

CREDIT CARDS: THE CASH COW

- Opaque disclosure leads to lack of focus and attention
- Capital light “brokerage” commission - swipes
- Growing 10+% a year
- 50%+ operating margins - Higher incremental margins
- Long term monthly cashflow with “float” characteristics
- No credit risk

JARGON – WHAT FEEDS SHINY OBJECT SYNDROME

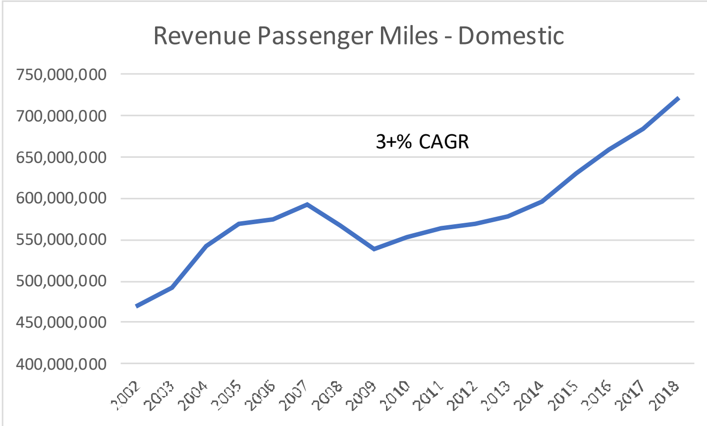
- Capacity
  - ASM's – Available seat miles
  - More capacity = more seats, more planes, more seats in more planes etc.

- Revenue
  - RASM – Revenue per average seat mile
  - $'s taken in per mile flown

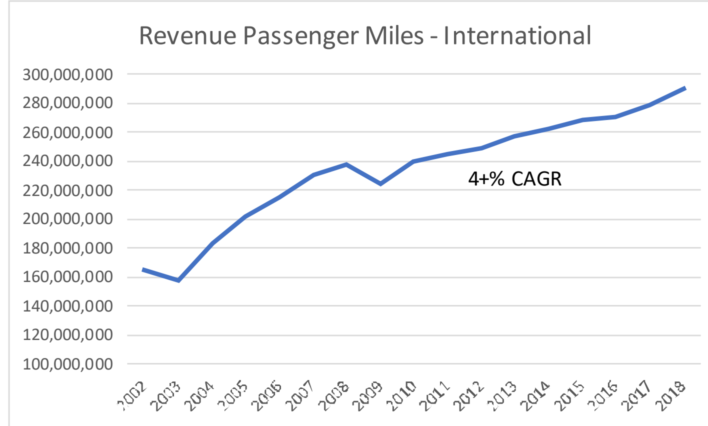
- Costs
  - CASM – Costs per average seat mile
  - $'s paid out per mile flown
  - CASM-EX – take out fuel component for the operating unit economics

- Legacy carrier = American, Delta, United
- LCC = Low cost carrier = Alaska, JetBlue, Southwest
- ULCC = Ultra low-cost carrier = Frontier, Spirit

SUMMARY AIRLINE CHARTS

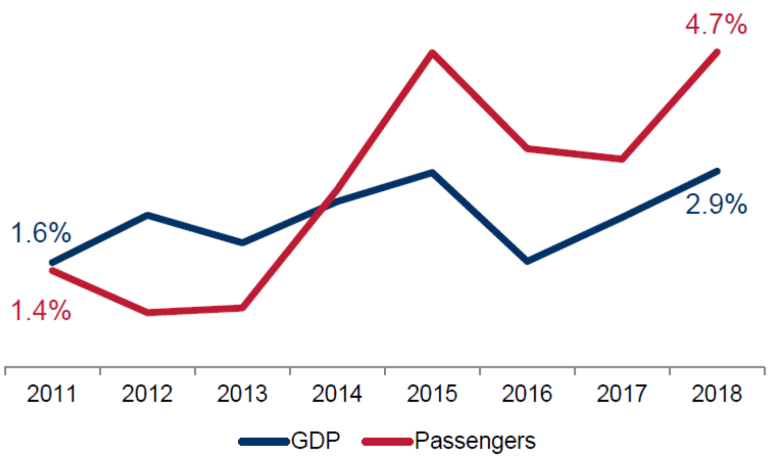


SOURCE: Bureau of Transportation Statistics T-100 Segment data.



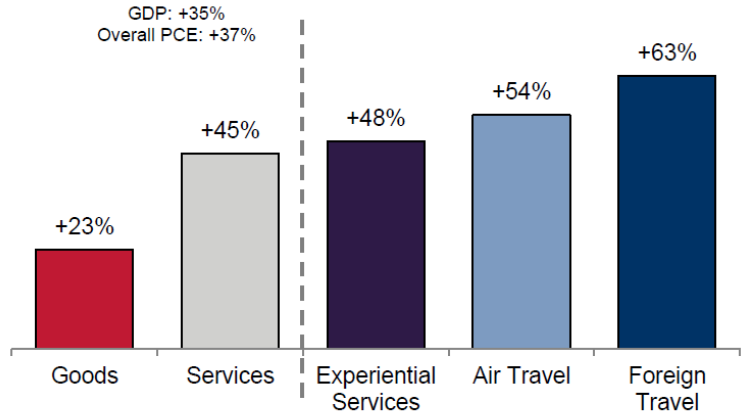
SOURCE: Bureau of Transportation Statistics T-100 Segment data.

Industry passenger demand growing *faster* than GDP



Experiential services are driving growth – particularly *air & foreign travel*

Growth in Personal Consumption Expenditures (2007-2017)

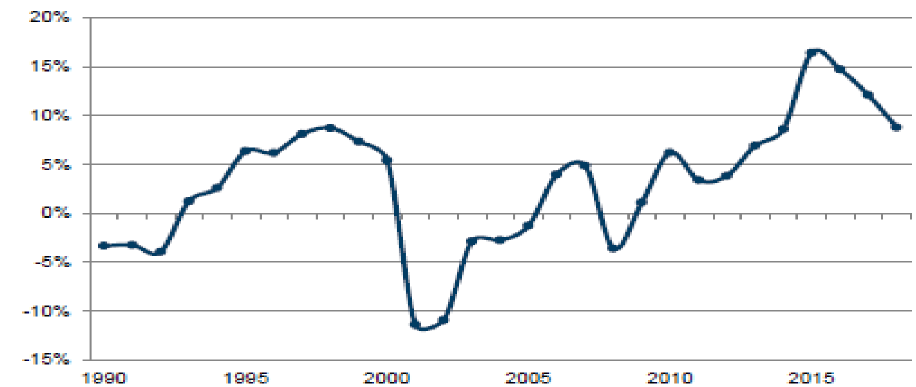


Note: Industry passengers sourced from Air Transport Association/Airlines for America and includes all U.S. passenger airlines; Growth in Personal Consumption Expenditures, source McKinsey & Co. (December 2017)

WHAT'S CHANGED?

- 2008 brought better balance sheets and consolidation
- More rational behavior and pricing
- Dominant hubs and route duopolies
- Technology – better revenue management (scheduling/pricing)
- More inelastic ancillary products (seats, bags etc.)

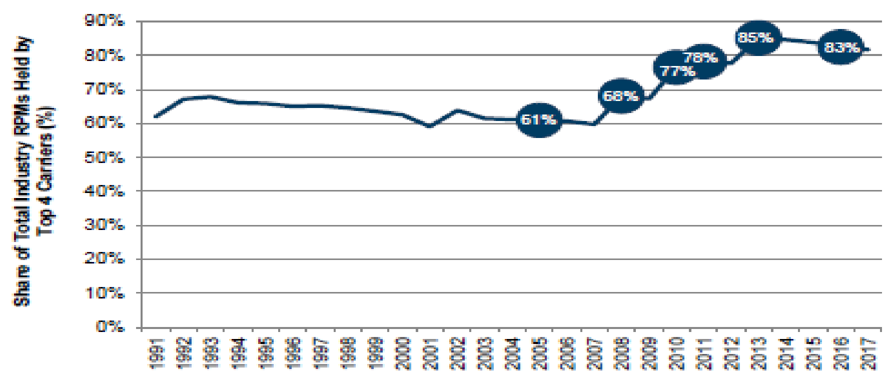
Exhibit 15: Industry Historical Operating Margins



Data as of June 30, 2018 and does not include cargo carriers

Source: Bureau of Transportation Statistics

Exhibit 16: Domestic Market Share of Top Four US Carriers



Step-ups in market share can be attributed in part to the following mergers: US Airways/America West (2005), Delta/North
(2008), United/Continental (2010), Southwest/AirTran (2011), American/US Airways (2013), and Alaska/Virgin America (201

Source: Bureau of Transportation Statistics, Goldman Sachs Global Investment Research

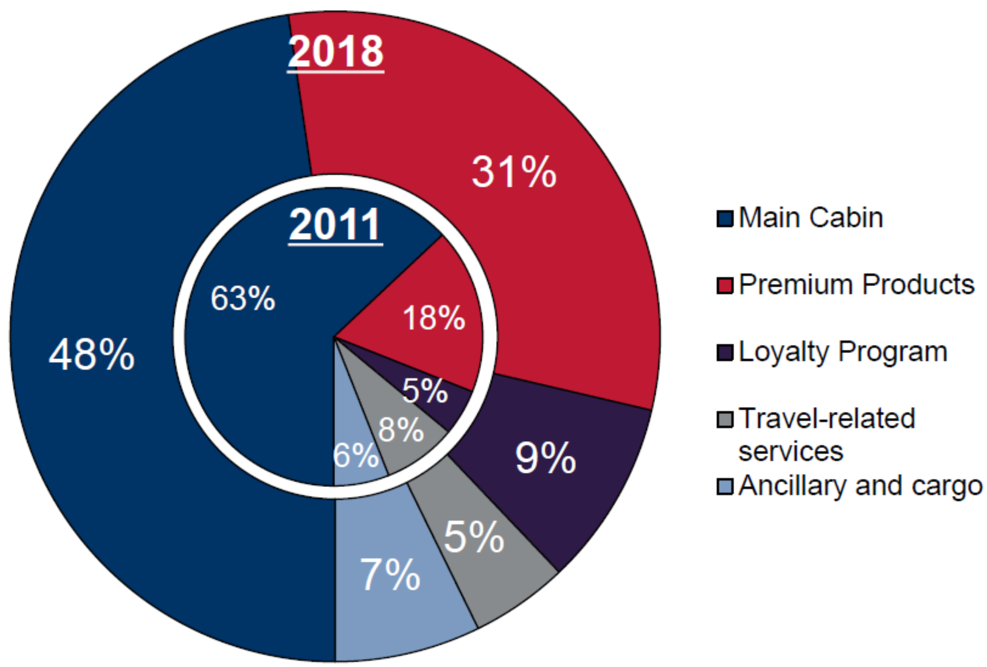
WHAT'S CHANGED

Increasingly Diversified Top Line Improves Resiliency

Momentum across the business with less reliance on Main Cabin product

- Larger portion of our revenue is now generated by more diverse, higher-margin revenue streams
- Since 2011, both premium ticket revenue and American Express have more than doubled, with strong future growth prospects
- Ancillary businesses are increasing in importance given strong growth potential and above-average margins

Total Revenue Components



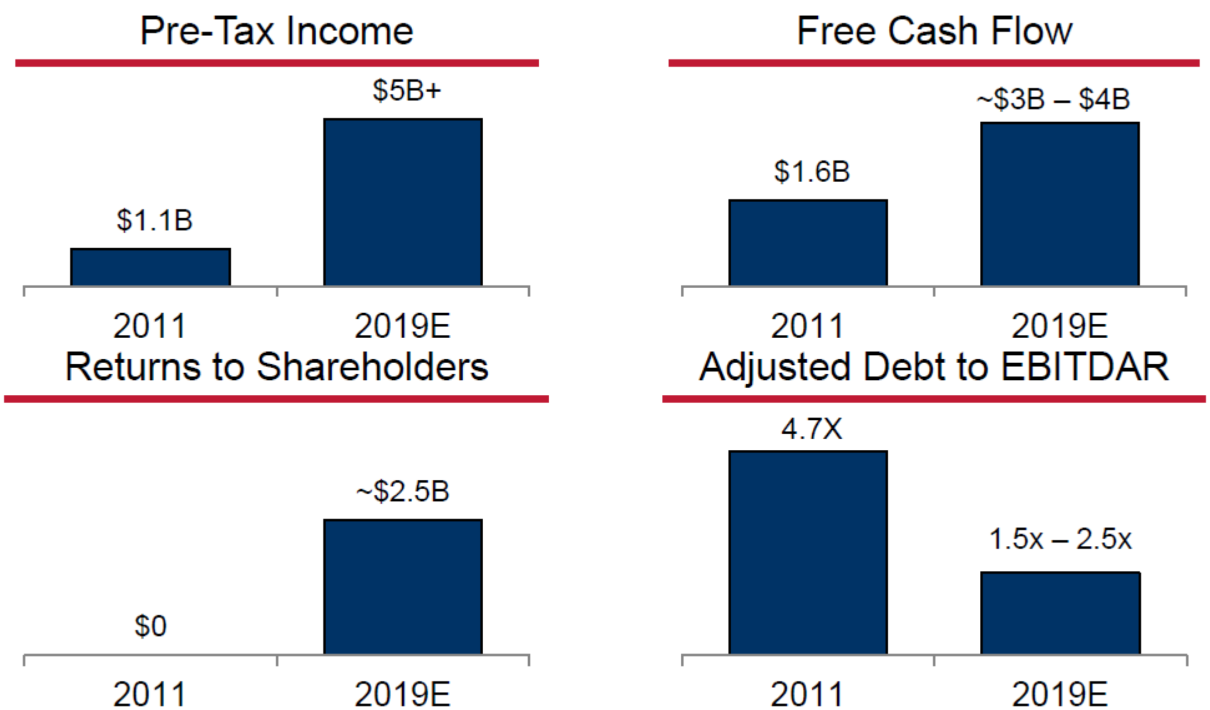
Note: Ancillary businesses include MRO, DAL Global Services, Delta Private Jets, Delta Vacations, Delta Material Services, and Delta Flight Products; 2018 reflects new accounting standards; DAL Global Services was sold in 2018

DELTA 4

WHAT'S CHANGED

Strong Financial Performance Supports Balanced Capital Allocation

Running a reliable, customer-focused airline is producing strong profits and cash flows, allowing for improved balance sheet strength and increased return of capital to shareholders



Expect 2019 will be 5th year with over $5B in pretax profits

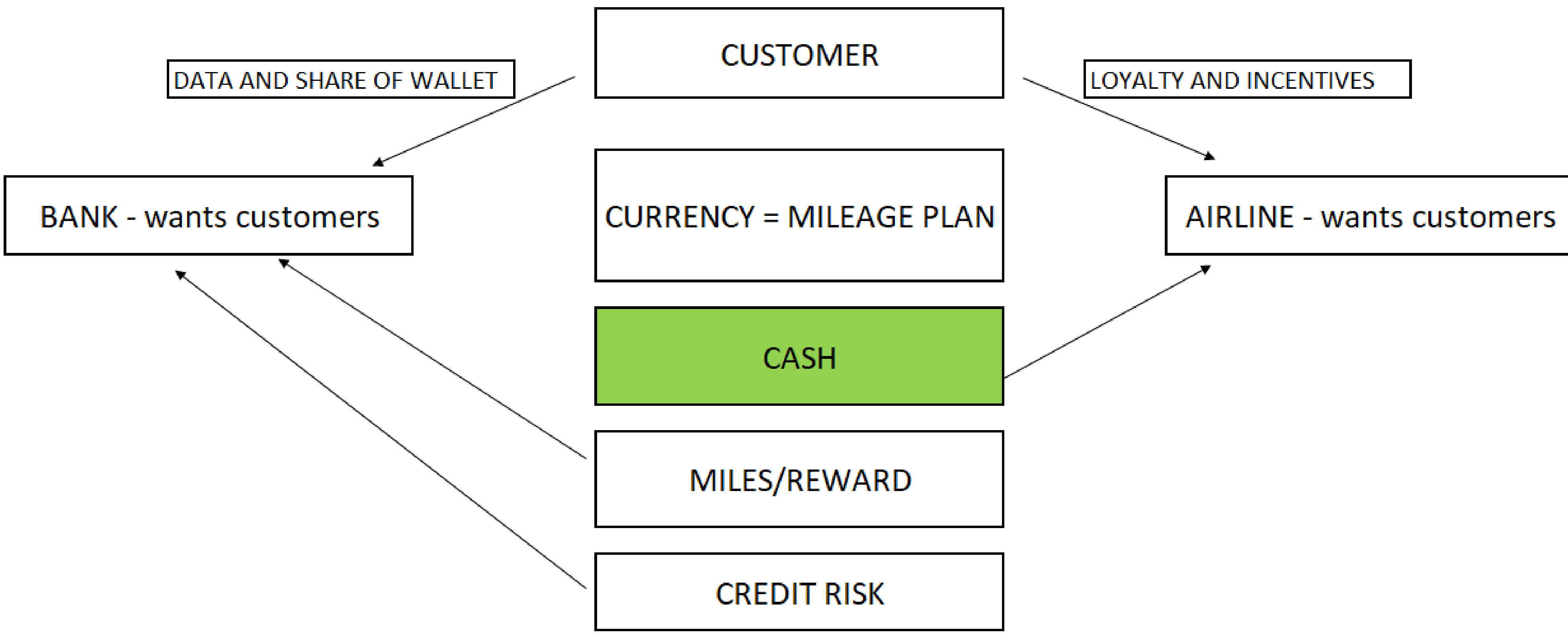
Consistent cash flow generation allows for significant investment in the business

Targeting return of ~70% of FCF to owners with steady dividend growth

Note: Non-GAAP financial measures reconciled in Appendix

DELTA

CREDIT CARDS: A CUSTOMER ACQUISITION CHANNEL FOR BANKS

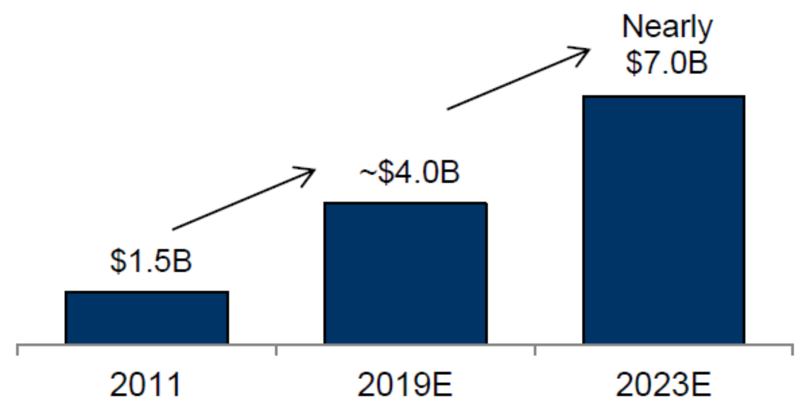


CREDIT CARD BUSINESS : DELTA/AMEX NEW DEAL

- New multi-year agreement through 2029 sets stage to create industry's most valuable co-brand portfolio
  - Expect benefit to reach nearly $7 billion by 2023

- Co-brand program has continued to gain momentum with record card acquisition for the past 2 years

Delta-Amex Contribution



DELTA – ROUGH MATH ON GETTING FREE PLANES

- $4BB of cash from Amex to Delta: ~50% margins = $2BB in FCF
- What's that worth?
- $2.0bb of FCF = ~$3 per share growing 10+% with minimal incremental capital
  - 15x? = $45
  - 17x? = $51
  - 20x? = $60
  - 25x? = $75
- The stock is trading at ~$55
- Airline should generate between $1BB-$2BB in FCF per year on average
  - $1.50-$3.00 per share
  - What's right price for the airline? You get it for close to free
    - 6x $1.50 = $9
    - 8x $2.25 = $18
    - 10x $3.00 = $30
- **<u>Total stock value of $54-$105: Little down…big up</u>**

ALK UP/DOWN EXAMPLE

- Caveat emptor – this is an example – please do your own work
- Most of the value comes from the credit cards

ALK Up/Down			
	Down	Base	Up
Credit Card Cash	$ 500	$ 500	$ 500
Multiple	12.0x	18.0x	20.0x
Credit Card Value	**$ 6,000**	**$ 9,000**	**$ 10,000**
Airline Revenue	$ 8,000	$ 8,000	$ 8,000
Operating Margin	7.5%	10.0%	12.5%
Airline FCF	$ 100	$ 300	$ 500
Multiple	8.0x	9.0x	10.0x
Airline Value	**$ 800**	**$ 2,700**	**$ 5,000**
Total Value	**$ 6,800**	**$ 11,700**	**$ 15,000**
Today's Market Cap	**$ 7,552**	**$ 7,552**	**$ 7,552**
Implied Price	**$ 54.8**	**$ 94.4**	**$ 121.0**
Todays Price	**$ 60.9**	**$ 60.9**	**$ 60.9**
PNL	-6.1	33.5	60.1
Dividend	$ 1.4	$ 1.4	$ 1.4
Total PNL	**$ (4.66)**	**$ 34.85**	**$ 61.47**
% of Long	***-8%***	***57%***	***101%***

CONCLUSION

- Airline reward credit cards serve as a high-return customer acquisition channel for banks.
- Underappreciated durable and growing cashflow from the secondary credit card business
- Airlines should eventually rerate given their more stable and predictable cash.

CONTACT DETAILS

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