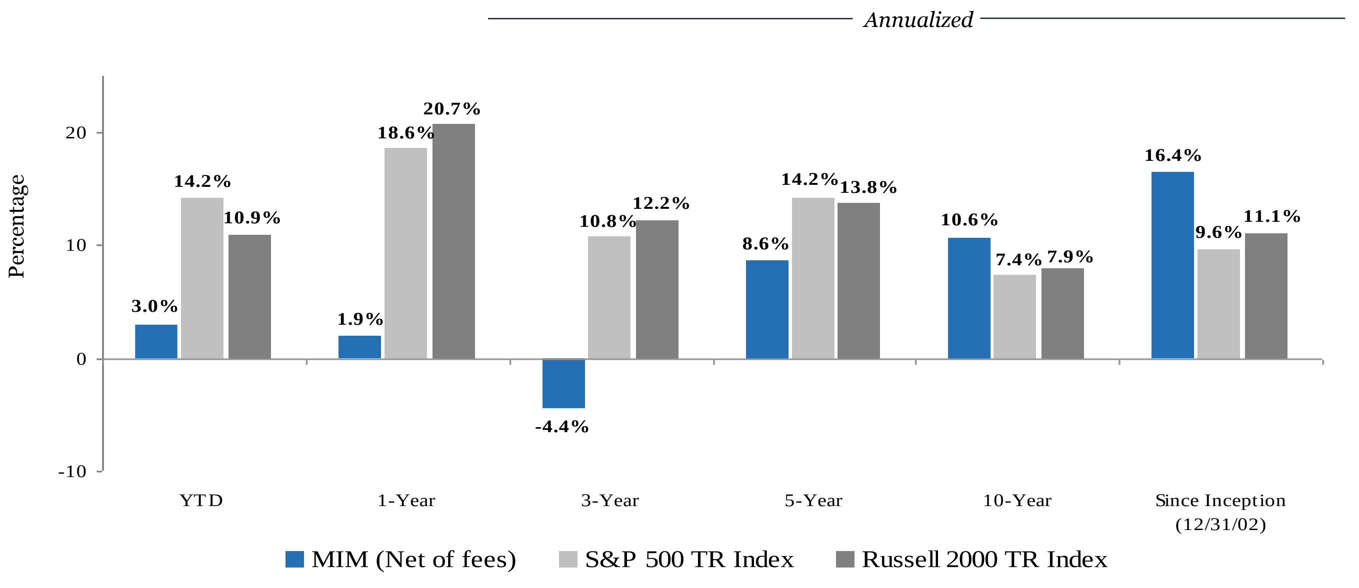
Chief Investment Officer Commentary – 10/31/17

Mittleman Investment Management, LLC's composite gained 3.7% net of fees in the third quarter of 2017, versus gains of 4.5% in the S&P 500 Total Return Index and 5.7% in the Russell 2000 Total Return Index. Longer-term results for our composite through 9/30/17 are presented below:



The top three contributors to our Q3 2017 performance were **International Game Technology (IGT)**: $18.30 to $24.55 (+36% with dividend), **Sberbank of Russia (SBRCY)**: $10.39 to $14.27 (+40% with dividend), and **Revlon (REV)**: $23.70 to $24.55 (+4%). IGT had a greater effect on performance than the larger percentage gain from Sberbank due to IGT's larger position weighting in the portfolio.

The three most impactful detractors from our Q3 2017 performance were **AMC Entertainment Holdings (AMC)**: $22.75 to $14.70 (-34% with dividend), **KT Corp. (KT)**: $16.64 to $13.87 (-17%), and **Rallye SA** (RAL FR): $20.58 to $18.51 (-10%).

After being one of our worst performers in Q1 and Q2 on slightly weaker than expected results in Q4 2016 and Q1 2017, **International Game Technology (IGT)** rebounded after a better than expected Q2 report, putting the stock at $24.55, just below its $25.52 price on 12/31/16. And while still down slightly year-to-date, the stock ended Q3 much higher than the $17.25 low price it hit in Q2, validating our call that the sell-off was a vast overreaction. Discussed at length in our Q1 2017 investment review, and again more briefly in our Q2 report, not much appears to have changed despite the volatility in the share price. So our estimate of fair value remains practically unchanged, down slightly from $35 to $34 (+38% upside), assuming 8.5x EV/EBITDA (2018 EBITDA est. of $1.7B), and 15x free cash flow (2018 FCF est. of $450). Their closest competitor in both lottery systems and slot machines, Scientific Games (SGMS $45.85), trades at 9.3x EV/EBITDA. And while SGMS has been growing faster than IGT recently, and has a higher EBITDA margin (40% vs. 35%), it also carries much more debt, with SGMS levered at 6.1x net debt/EBITDA, versus 4.2x for IGT. We see IGT as being in the process of regaining market share in the slot machine business, holding share in the lottery business, and improving profitability overall. A stronger than expected EUR/USD in Q3 should boost results when reported in late November, and a ticket price increase for the Mega Millions lottery in the U.S., from $1 to $2 effective in October, to better match the larger Powerball jackpots, should benefit Q4 results noticeably. A slow-growing, recession-proof business like this should not be available at 11x FCF.

NOTE: Past performance is no guarantee of future results. Performance results presented are preliminary, net of fees and include the reinvestment of all income. Individual account returns may vary from those presented due to differences in the timing of contributions and withdrawals, and account start dates. Refer to the important disclosures on page 7.

Sberbank of Russia (SBRCY), continues to rise along with its earnings, and despite its nearly 28% total return year-to-date, at $14.27 it still trades at a meager P/E ratio of only 6.2x estimated earnings per ADR of $2.32 for 2018, despite a 21% ROE. J.P. Morgan Chase (JPM $95.51) has a P/E ratio 13.3x, with an 11% ROE. Even the sickly Deutsche Bank (DB $17.28) trades at a P/E of 10.1x, with a 4% ROE. And Russia, despite a slower GDP growth outlook than the U.S. or Germany, still has better long-term growth prospects for financial services such as home mortgage loans, auto loans, and credit cards, as penetration for these basic credit products is very low in Russia, where household debt is only about 15% of GDP, versus 79% in the U.S., and 53% in Germany. Our initial purchase of Sberbank was poorly timed, at $10 per ADR in June 2014, on its way to $3.08 in December 2014 while some were calling Russia "absolutely uninvestable" at the time. But rather than joining in the panicked selling back then, we bought more on the way down, lowering our average cost substantially in the process. We now have a large unrealized gain on the position in just over three years since our woefully premature entry point, and have received decent cash dividends, and view fair value as $24 (68% upside potential) at a P/E of 10.3x. We recognize the unique risks of investing in Russia, where the price of oil dictates the value of the Ruble and so much of the profitability of this preeminent banking franchise, and there is geopolitical risk as always. But Sberbank endured the downside of those risks in 2014 through early 2016, and proved its resilience by not losing money throughout the two years that Russia just spent in recession, nor did they lose money during the Great Recession / Global Financial Crisis. Profits contracted dramatically, but they didn't go into the red, and they quickly recovered. Sberbank should produce USD net income in 2017 that approximates its prior peak earnings from 2013. Deutsche Bank lost billions in 2008, and has yet to reclaim its prior peak earnings of 2007. We think 6.2x earnings for Sberbank, one of the largest and best run banks in all of Europe is much too low, including any discounts that might be reasonably applied for the commodity price, currency value, and corruption risks inherent in a bank domiciled in Russia. But considering the multiple frauds discovered recently at Deutsche Bank and Wells Fargo (WFC $55.15, P/E 13x), perhaps the market is applying a valuation discount to the wrong bank.

Revlon (REV), our largest position, closed up just slightly in Q3, but only after some fairly intense volatility which saw the stock drop from $23.70 on 6/30 to $15.60 (-34%) on 8/4, then rebound to $27.90 (+79%) on 9/28, before settling back at $24.55, up 4% on the quarter. The stock hit its low for the quarter on the day of its Q2 earning report, 8/4, which was another disappointing result, with ongoing weakness in their U.S. mass market sales (about 30% of total company sales) for color cosmetics. We continue to feel that the weakness in Revlon's North American consumer sales will prove transitory, and appears to be in the process of moderating as Nielsen scan data for September shows Revlon sales down at a much reduced rate, while Coty's sales (Cover Girl, Rimmel) declined at a significantly worse rate. Revlon's international sales (about 50% of total company sales) remain strong. Revlon's new product launches for their Almay unit, along with revamped branding, appear to be gaining some traction, and similar refreshes for their Elizabeth Arden and Revlon units are planned to roll out soon. We bought more stock on the weakness, and noticed that we were not alone. Revlon's controlling shareholder, Ron Perelman, aggressively acquired more stock in Revlon during Q3, increasing his stake from 81.9% at the end of Q2, to 84.65% at the end of Q3, an increase of about 1.45M shares. That was in addition to the 2.44M shares he bought from May 8th through June 20th, as we noted in our Q2 Investment Review. This nearly relentless buying on Perelman's part prompted us to file a 13D once we exceeded the 5% ownership threshold in August to express our concerns to Revlon's Board of Directors about Perelman's ultimate intent with regard to minority shareholders. We asked the Board for a 5-year standstill agreement or a poison pill to limit Perelman to less than 90% of the shares (the threshold for a short-form merger, which requires no shareholder vote and likely no premium). What was granted was a 1-year pseudo-standstill agreement which offers thin protection to minority shareholders. Our two 13D letters to Revlon's Board, and Perelman's response to our first letter (no response yet to the second one), are viewable via this link: http://www.mittlemanbrothers.com/revlon-13d/

We have devoted many pages to Revlon in our last two quarterly investment reviews, so we won't repeat all of that here. Suffice it to say that we cannot imagine Revlon selling for less than 2x sales in a private market transaction, and that's $50.

Revlon's main competitor, Coty (COTY $16.53), is trading at EV/sales multiple of 2.2x, and EV/EBITDA of 13x on calendar 2018 consensus estimates, despites performing materially worse than Revlon in the North American mass market channel year-to-date. Revlon at 2x sales would be $50, which would be a 14.7x EV/EBITDA on our estimate of $375M in adjusted EBITDA for 2018. As a frame of reference, when interest rates were much higher (implying valuations should have been lower), Johnson & Johnson (JNJ) paid 19x EBITDA (3.4x sales) for Neutrogena (NGNA) in 1994, and L'Oreal paid 14.7x EBITDA (2x sales) for Maybelline (MAY) in 1996. These examples highlight the potential upside achievable in Revlon's shares if the company returns to growth after this year's setback, and if minority shareholders are protected. We are highly confident in Revlon's ability to achieve the former, and we are exploring all options with regard to ensuring the latter.

A number of new initiatives are due out of Revlon in Q4 2017 and into Q1 2018: products launches, enhanced retail distribution (bigger space at Ulta beginning Q1 2018), and new ad campaigns from new ad agency, Grey Advertising, of WPP. Perelman's aggressive open market stock purchases over the past few months at around $20 per share, taking his stake from 77.3% to 84.7%, support our contention that the stock is likely very cheap here. The last time Perelman bought a lot of Revlon stock was in 2009 when it was just over $5, and it closed that year at $17.

Regarding our most impactful decliners in Q3, **AMC Entertainment Holdings (AMC)** topped the list, with a -34% total return, and after a -27% drop in Q2, AMC has clearly been the most damaging position for our performance year-to-date. But as quickly as Revlon rebounded from its recent lows, and as IGT did similarly, we think AMC should snap back up fairly soon as well. We covered AMC at length in the prior Investment Review for Q2, and went over our reaction to the lowered guidance that came out during Q3 just before we sent out that letter, so we won't repeat that since there has been no change in our views since then. The only change is that the box office weakness we noted then has persisted and become worse, such that AMC's revised guidance for 2017 (based on box office ending -1.5% this year versus -5.2% YTD now) does look a little more vulnerable to further downward revision unless we see the very strong numbers expected actually materialize from the upcoming tent-poles like *Thor:Ragnarok*, *Justice League*, and *Star Wars:The Last Jedi*. AMC is the world's largest movie theater exhibitor, and suffered from an unusually weak Summer box office. Yet with an encouraging Fall and Winter slate of movies, we expect a near-term reversal that should accelerate towards the next Star Wars movie release in December. AMC, at its $14.70 quarter-end price, has a sustainable 5.4% dividend yield and the business is trading at 5.5x FCF (18% FCF yield), which is the kind of extreme one rarely sees in a fairly stable, recession-proof business. Sure, the Summer box office was weak, but 2016 was an all-time record for North American box office receipts, for the 4th time in 5 years. And we've seen this movie before, having watched shares of our former holding Carmike Cinemas (CKEC) drop from an interim peak of $19 in 2010 to less than $5 in 2011 on a very poor Q1 2011 box office (-20%) followed by a weak Summer box office. Five years later we were selling CKEC at $33. We believe we are being conservative by assuming a lower than consensus EBITDA estimate of $900M for AMC in 2018, and $350M in FCF to arrive at our fair value estimate of $32.60 for AMC, which represents 122% in upside potential from $14.70 and is only 12x FCF of $350M and 9.5x EBITDA. We took advantage of the recent AMC stock price weakness by adding to the position, bringing the weighting up from 10% to 12.5% at cost. We think the market is missing the extent to which the reserved recliner seat conversions that AMC has led in the U.S. (not even half-way done here yet) and is about to roll-out in Europe can drive increased attendance by vastly improving the movie-going experience. AMC's CEO, Adam Aron, has overseen a revamped loyalty program ("AMC Stubs") grow from 2.5M members just over one year ago to exceeding 10M members today. They have sold non-core investments to fund a $100M share buy-back program, and the CEO has bought shares personally at $31.50 (31,747 on 2/13/17), $24.72 (10,000 on 6/2/17) and $15.79 (35,000 on 9/14/17) which while not a huge amount ($1.8M in total) to invest for a guy who made $12.4M in total compensation in 2016, it is still a decent investment and an encouraging sign of confidence to other AMC shareholders, and something that we would like to see more of from some of the CEOs and directors at our other portfolio-held companies.

KT Corp. (KT) was our second most impactful detractor from our performance in Q3, dropping 17% from $16.64 to $13.87. This company is somewhat like the Verizon of South Korea in terms of core business lines. KT is the #1 broadband provider in South Korea, with 1-Gigabit speed, and the #2 player in cell phone service (31% market share), along with a collection of smaller businesses. We last wrote about it in our 2016 Year-End Investment Review as it had dropped similarly in Q4 2016, that time on fears that the Chairman and CEO might have to step down due to some apparent accommodation of influence-peddling by former President of South Korea, Park Geun-hye, who is now in jail. Fortunately, KT's CEO was not forced to step down, as he has done an excellent job running the company since he took over in early 2014. The reason for the current stock price drop was due to a change in government regulation on the maximum tariff the mobile telecom service providers can charge their new customers. The stock price drop seems overdone, as this one time hit to earnings (maybe a 7% reduction) won't be recurring anew each year, it just lowers the base a bit, from which the business should still grow nicely. KT, in partnership with Intel, among others, will launch the first 5G trial at the PyeongChang Winter Olympics in Feb. 2018. They are also working on systems for driverless cars. The company has been selling non-core assets over the past few years to reduce debt, and they still have some valuable commercial real estate yet to be sold. But they have largely succeeded in cutting costs, reducing leveraging, and EBITDA and FCF are growing again. The stock is obscenely cheap, and we see a minimum of 73% upside from the quarter-end price of $13.87 to our estimate of fair value at $24, which is targeting only an EV/EBITDA multiple of 4x ($4.45B consensus estimate for 2018) and a P/FCF multiple of 10.4x ($1.2B est. for 2018). Verizon (VZ $49.49) trades at 7x EBITDA and 13.5x FCF, and likely will not grow as fast as KT going forward given that KT is centered in a faster growing part of the world. Obviously if war breaks out with North Korea this stock might not do very well for at least some time, but given China's immense leverage over North Korea, and their presumed interest in not seeing one of their largest trade partners reduced to ashes, we think China will intervene in NK if needed to prevent that nightmare scenario from becoming reality. If Xi Jinping cannot project power effectively in China's own backyard, over what is essentially a client-state, it would be well beyond humiliating and possibly devastating to his regime. So operating under this assumption, we are not expecting a restart of the Korean War, as China simply has too much to lose. That said, the guns of August 1914 utterly defied rational self-interest, so we are monitoring that situation closely and understand that our underlying premise of no war on the Korean peninsula could be wrong.

Rallye SA (RAL FP) was down 10% in Q3, as their core holding, a controlling stake in grocery store conglomerate Casino Guichard (CO FP) dropped on news that Amazon was talking to French grocers, including Casino Guichard, about establishing a partnership to help Amazon with distribution if they decide to enter the grocery space in France. The markets' concern about Amazon overshadowed good operating results from Casino Guichard's grocery stores in France (like Monoprix) and Brazil (GPA). We think the potential threat of Amazon entering the grocery business in France or Brazil is worth watching, but likely not a near term threat to the cash flows of these business, nor the $4B in appraised value of the underlying real estate they own in France. There was also talk of Amazon potentially buying one of Casino Guichard's chains in France, or one of their competitors, as they did recently buying Whole Foods in the U.S., but no further details are known at this time. We continue to think that Rallye SA is worth $30 (+62% from quarter-end closing price of $18.51) on a sum of the parts basis, and while their substantial grocery store businesses in Brazil and Colombia continue to improve, Rallye's 8.4% dividend yield pays us well to wait. French billionaire, Jean-Charles Naouri, who owns over 50% of Rallye's stock, has a good track record of value creation, especially with regard to the development of real estate associated with Casino-Guichard's various grocery chains and other retail operations around the world.

Sold Position:

Gazprom (OGZPY) was sold at a loss in Q3 as we needed funds for two new investments described on the next page and while we still like Gazprom's risk/reward, valuation, dividend, etc., we like the new entrants more.

Recent portfolio additions:

"Have opinions at extremes, and wait for extreme moments." – Joe Rosenberg, former CIO for Loews Corp.

That quote was his response to the question, "how does one beat the stock market indices?" from an interview that I read in *Barron's* in 1992 I think it was, which influenced me to be deliberately patient and prepared for truly extreme opportunities, instead of being too eager to swing the bat at just a good pitch. These two new entrants to the portfolio this year are examples of me trying to put that advice into practice yet again, hopefully with better results than Gazprom produced.

Village Roadshow Ltd. (VRL: AU): We started buying shares of VRL in Q1 of this year, but have withheld discussing it publicly until we established our targeted portfolio weighting of about 5% which we achieved just as Q3 was ending and coincidently resulted in us owning just over 5% of the company's outstanding shares, making us their 3rd largest shareholder. I first came to know of Village Roadshow in 2000 as I was doing research on Carmike Cinemas and their bonds, with Carmike then in bankruptcy, and Village Roadshow was on the list of global comparables. The company got its start in 1954 as one of the first drive-in movie theater chains in Australia, eventually expanding into traditional movie theaters, and other entertainment-related ventures that were bought and sold during the past 63 years that they've been in business. The main units today are theme parks, movie theaters, and movie distribution. The founding families, Kirby and Burke, still retain effective control of the company with a 41% stake. They have a long history of extracting substantial free cash flows from the businesses they've owned and buying and selling them generally at good prices. Shareholders have benefitted via excellent regular dividends and occasional special dividends and a generally appreciating share price. But their film distribution business hit a rough patch in early 2016, and some weather-related weakness in the theme park business piled on, so the stock fell from nearly A$7.00 to A$5.00 in February 2016. Then in late October 2016 there was a terrible accident at a competing theme park called Dreamworld, in which four people were killed. Attendance at all theme parks in the region dropped dramatically, and VRL announced lower than expect earnings in early 2017 along with a suspension of their cash dividend as a result of the diminished earnings from their theme parks unit, usually about a third of total EBITDA. The stock fell from A$4.00 to around A$3.50, and we started buying it there. We own about 8.4M shares now, just over 5% of the shares outstanding, at an average cost of about A$3.75 (USD 2.90), roughly where the stock is today. We think fair value is A$6.50 (USD 5.00), up 73% from current price, based on a blended target value of 9.5x EBITDA (A$151M/US$117M), and 18x FCF (A$45M/US$58M). Our thesis: the theme park business returns to normal at some point, and the dividend comes back, which would provide a 7.5% dividend yield on our cost basis (current price) if reinstituted at the former rate, and a 4.3% yield at our target price.

Aimia Inc. (AIM CN): Aimia is a leading provider of coalition loyalty marketing programs like Aeroplan in Canada and Nectar in the UK. We initiated our position in May following a >60% one-day decline in its stock price after the company announced that Air Canada, its largest partner, would not renew its contract that is set to expire in 2020. The stock dropped an additional 25% in response to the Aimia's mid-June announcement of a suspension of its dividend. We presumed that the dividend would be suspended upon entering the stock and believed this was a sensible course of action in order for the company to pay down its debt. Aimia produces significant free cash flow and trades at an extremely low valuation, and there is both the possibility and likelihood that Air Canada will be replaced by other airline partners. Through its joint venture with Aeromexico (AEROMEX MM), Aimia also owns a 48.9% stake in Mexico's leading coalition loyalty program that in MIM's estimation is worth more than the current share price alone. The stock price decline, that we believe we took advantage of, was exacerbated by both sales of funds mandated to hold only dividend paying stocks, and index funds that were forced to sell it upon its exit from various indices, as well as panicked individual investors who fail to realized that even if Aeroplan became worthless due to Air Canada's exit from the program in 2020, equity investments and other subsidiaries, combined should result in equity value well in excess of the current stock price. And if Aeroplan does find replacement partners for Air Canada before 2020, the fair value for the share price would be triple the current price, which we think will be the case. These coalition loyalty programs are not popular in the U.S., although American Express is trying to build one called "Plenti," yet they are very popular in Canada and the UK and many other countries. These are negative working capital businesses with sizable float and a very high conversion of EBITDA to FCF. Think Berkshire Hathaway's Blue Chip Stamps, or any airline's frequent flier program (the most lucrative part of any airline company), or American Express' Membership Rewards program…the economics are similar. We are Aimia's second largest shareholder now, with just over 10% of the shares outstanding. Our average cost is USD 1.53 (CAD 1.97). It closed the quarter at USD 1.98 (CAD 2.47). We think fair value based on a sum of the parts is a minimum double from current price, and likely a triple if Aeroplan survives the 2020 departure of Air Canada, as we expect it will.

The Economist calls the recent run up in a multitude of asset prices, "The Bull Market in Everything." We sheepishly beg to differ, despite seeing the Dow Jones north of 23,000. And yet back in October 2011 the cover story was "BE AFRAID" with the Dow Jones at 11,000 and a double-dip recession supposedly right around the corner.

We were not drinking the hemlock back in 2011 when the world was supposedly ending because Greece was in flames and the Euro was disintegrating, and we are not drinking the kool-aid today with consumer confidence at levels not seen since 2000, and money so easy to make you can literally invent your own currency. But our portfolio is much as it was in 2011, much cheaper in valuation than the market indices, with a more resilient / less cyclical business profile overall. So while we have been left out of this recent party, much like we were in 1999, we expect our abstinence will be vindicated in the end.

Sincerely,

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Chief Investment Officer - Managing Partner

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IMPORTANT DISCLOSURE

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