

## **Delta seeks ways to avoid bankruptcy**

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Delta has come a long way from its origins as an aerial crop dusting company in 1924 and its inaugural flights in 1929 when five passengers made the trip from Dallas to Louisiana.

Having emerged as the third largest carrier in the US in its 75th anniversary year, another inaugural event looms: its first ever trip to the bankruptcy court.

To avoid that prospect, Delta is trying to mimic American Airlines' success last year in overhauling its labour and some other costs outside bankruptcy. Yet Delta wants to go further, seeking strategic changes such as fare simplification, a new labour agreement and a restructuring of its \$20.2 billion of debt outside Chapter 11.

Its financial problems are evident. Delta lost \$3.3 billion between 2001 and 2003 and had a \$241m operating loss in the recent quarter. It has the highest pilot costs in the industry, after United and American secured cheaper agreements. Its cash has fallen from \$2.7 billion at the end of December to \$2 billion at the end of June and could fall to \$1.3 billion by the year-end. It has warned it has no new sources of capital.

The easiest problem to resolve could be labour. Delta has just one union to deal with, the pilots. They have so far offered less than the \$1 billion Delta has sought in cuts and pension changes, but the pilots know the give-backs would only get higher in bankruptcy.

Even if the pilots do agree a new contract, that still might not be enough to secure the airline's competitive position. Gerald Grinstein, chief executive of Delta, has said his aim is to do the restructuring "once and do it right", yet a concern is that United could soon set a new benchmark.

It could revise its labour contracts to attract new capital and terminate its defined benefit pension plans. Delta could be stuck with a six-year wage contract and higher pension costs, which could put it at a competitive disadvantage.

Concern about pensions is having an immediate impact on pilots, who are voting with their feet. Delta took a second-quarter non-cash \$117m settlement charge related to lump-sum payments under the defined benefit plan for 356 pilots who retired, many early.

Delta expects further charges from early retirement, which could affect its operations. Senior pilots, who fly bigger aircraft, are more likely to retire, leaving an experience gap.

Retirements could "negatively impact our revenues and increase our pension funding obligations", it has warned. Approximately 2,000 of our 6,900 pilots are currently at or over age 50 and thus are eligible to retire."

The biggest challenge is debt reduction. Phil Baggaley, analyst at Standard & Poor's, says Delta has the highest net debt to revenues ratio of the industry, at 130 per cent, compared with 102 per cent for American and 108 per cent for Northwest. "They are being far more ambitious than American was in looking at debt," Mr. Baggaley says. "US Airways also tried to do a bit and didn't succeed."

Two considerations will drive creditors' willingness to negotiate. How much will they lose in a bankruptcy? And how difficult is it logistically to work out a deal?

Mark Streeter at JP Morgan says Delta's debt breaks down into \$4.7 billion in unsecured bonds, \$2.1 billion in public ETCs (equipment trust certificates - debt backed by aircraft), \$4.9 billion in EETCs (enhanced ETCs), and \$8 billion-\$9 billion in aircraft lease deals.

This high amount of unsecured debt is a plus - these debtors have the most to lose in bankruptcy, so have an incentive to negotiate.

"Those easiest to negotiate with are private banks or leasing partners," says Mr. Baggaley. "Unsecured bond holders have the most to lose but these are widely held, so logistically it is hard. ETCs are better secured than unsecured holders but less than EETCs, which are widely held."

Faced with so many debtors with mixed incentives, there are already warning signs that the credit talks will get bogged down. Last Tuesday, law firm Bingham, which represents a committee of 34 institutions that hold \$1.3 billion of debt such as EETCs and have interests in 169 aircraft, asked for an extension to a deadline of tomorrow to agree to waive some contractual restrictions that limit Delta's ability to restructure its debt.

One investment banker said: "I don't see how they can get enough out of it from bondholders and lessors to stay out. Probably they are seeking a pre-planned bankruptcy filing and, with the exchange offer, trying to get people moving in the right direction."

Much will depend on how long Delta can keep talking before its cash runs so low it does not have enough to finance a bankruptcy. Fuel costs are likely to be the swing factor, governing how long it can afford to drag out talks, and setting the bar on what it needs in concessions.

Delta still has some time but not much. It faces \$1.2 billion in debt payments as well as pension obligations and lease payments in 2005. Although Mr. Grinstein, 71, does not want a bankruptcy as his legacy, he told the annual meeting in April: "My job is to make sure we reach our 100th anniversary." The best way to assure that could yet be a bankruptcy filing.