

Tilton's troubles

By: John Pletz July 13, 2009
Crain's Chicago Business

Glenn Tilton's turnaround at United Airlines is turning into a round trip to financial purgatory.

Chicago-based United's cash is evaporating as the recession chokes off air travel. **With more than \$1.5 billion in debt coming due by next year, Mr. Tilton can only hope the economy recovers before the cash runs out. Some think United can survive current conditions only until mid-2010.**

"They could be in a position where they are in danger of running out of cash," says analyst Bill Warlick of Fitch Ratings Inc. in Chicago.

Financial markets are betting United won't make it. Its stock and credit-default swaps on its debt trade at levels indicating bankruptcy is likely. New York-based debt analyst Roger King of Credit Insights says the sky-high interest rate on a recent United financing suggests the airline is "just a few steps from the grave."

That's far from the flight path Mr. Tilton, 61, envisioned when the longtime oil industry executive took charge of a struggling United in 2002. He expected to purge excess costs in Chapter 11 bankruptcy proceedings, then initiate a badly needed airline industry consolidation with a sale or merger that would send him into retirement with a handsome payday.

"That was Glenn's plan — to consolidate," says Mo Garfinkle, CEO of Virginia-based GCW Consulting LLC, who has advised Mr. Tilton and United. "The game plan now is to survive."

United's stay in bankruptcy lasted three years as Mr. Tilton battled unions for pay cuts and other concessions. Eventually, he slashed overall expenses by 7% and cut payroll by 39%, eliminating 22,000 jobs.

But an expense Mr. Tilton couldn't cut knocked his recovery plan off course. Just as United was returning to profitability in 2007, a surge in oil prices sent jet fuel costs soaring. The former oil man hadn't hedged against the spike as other airline execs had.

Burdened with \$3 billion in debt taken on to finance its exit from bankruptcy, United was poorly positioned to absorb the additional expenses. It nose-dived into the red again, posting a loss of \$5.3 billion in 2008.

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A weakened United made an unattractive merger partner, scuttling step two of Mr. Tilton's game plan. His first choice, Atlanta-based Delta Air Lines Inc., chose Northwest Airlines Corp. of Minnesota instead. Mr. Tilton settled for an alliance with Houston's Continental Airlines Inc. that some dubbed "merger lite."

Meanwhile, the deepest recession in 25 years bludgeoned airlines, grounding the business travelers United depends on so heavily. Mr. Tilton responded by aggressively slashing flights, a move that slows the financial bleeding but makes United vulnerable to new competitors, including Dallas-based Southwest Airlines, which is bringing its low-fare strategy to business destinations like New York and Boston.

But United's financial weakness limits Mr. Tilton's options. By choosing to fuel the airline's bankruptcy exit with debt rather than equity, he made it more vulnerable to adverse shifts in expenses and demand.

That vulnerability is now manifesting itself in a liquidity crunch. A cash cushion that had reached \$3.7 billion stood at \$2.5 billion as of March 31, and with oil prices on the rise again, Fitch's Mr.

Warlick predicts, "United could report substantially negative free cash flow for the final three quarters of 2009." He downgraded United debt on June 10 to CCC, deep in junk status.

WHERE NEXT?

With his original strategy in tatters, Mr. Tilton has given little sign of where he plans to take United next. He hasn't invested in the new planes United will need over the long term, an expense he expected to avoid by cutting a merger deal. Recently he announced plans to buy up to 150 new aircraft in the coming years, but it's not clear how United would finance such a purchase.

Of more immediate concern is the debt coming due in the months ahead. **The company faces \$660 million in debt and lease payments by yearend and more than \$1 billion in additional payments next year, followed by \$869 million in 2012.**

United's lenders and credit card partners have bailed it out before, suspending or relaxing loan covenants a year ago. They also could renegotiate loan terms to give United more breathing room.

But Mr. Tilton is nearly tapped out after selling stock, mortgaging aircraft and selling frequent-flier miles in advance during the past year. **United now has about \$1.2 billion in unencumbered assets, down from \$3 billion a year ago.** Credit-card companies could require United to post more cash collateral if its reserves drop further.

Mr. Tilton declined an interview request, but a United spokeswoman says, "We have a proven track record of being able to leverage those assets — modest debt payments over the next three quarters, minimal capital spending and no aircraft deliveries."

But when United mortgaged \$500 million in spare parts last month, it was forced to pay 17% interest, instead of the 12.75% it had hoped.

Kathryn Mikells, United's chief financial officer, insists the interest rate reflects that spare parts are harder to finance than aircraft, not the airline's financial prospects. "While we are very sensitive to the cost we are paying for incremental liquidity, we also recognize that not all transactions are created equal and those with a tougher structure are going to demand a higher rate," she told employees July 2.

Nevertheless, Mr. Warlick wrote last month that "Fitch views United's highly leveraged capital structure as unsustainable in the absence of a sharp turnaround in industry operating fundamentals."

It's far from clear that an economic recovery will restore business travel to the levels that once fueled United's profits.

Business travel has been hit hardest in the downturn, falling 20% this year, according to the International Air Travel Assn. Vaughn Cordle, CEO of Virginia-based Airline Forecasts LLC, predicts business travel will remain 10% below pre-recession levels, even as industrywide revenue climbs by 6% to 9% next year.

And with Southwest and other newcomers targeting the sector, fares are falling on key business routes such as Chicago-New York.

A growing consensus among industry observers holds that excess capacity and a weak travel recovery could force a major airline into liquidation, with United, American and U.S. Airways the most likely victims. Insurance against default on United debt — known as credit default swaps — trades at 60 cents on the dollar, while its shares trade below \$5, indicating investors consider bankruptcy likely.

With so many of its assets already encumbered, United might not find lenders willing to finance a second bankruptcy reorganization. As Mr. Warlick notes, "The ability to restructure with another trip through bankruptcy is diminished because nobody wants to extend credit."

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