

BUSINESS

Hard calls helped pull Frontier from bankruptcy

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The numbers on the board didn't lie.

Frontier Airlines chief executive Sean Menke and his senior staff had been obsessively tracking the carrier's fragile finances since filing for bankruptcy on April 10, 2008.

The dry-erase board in Menke's office showed deals ranging from \$2 million to \$80 million — deals that had to happen to pay the bills.

It was mid-July 2008, when a combustible combination of skyrocketing fuel prices, little cash, tight credit and stiff competition for fewer customers led to what seemed an inevitable conclusion: Frontier had to shut down.

Drained after yet another day of juggling numbers, Menke and chief financial officer Ted Christie headed to the patio of a nearby pizza place for a beer, Stella Artois for Christie and a Fat Tire for Menke.

It had been a hard-fought ride, but now they faced the cruel truth.

"Tomorrow's the day," Menke told Christie.

On Oct. 1, Frontier emerged from bankruptcy, its brand, its tail animals and its pride intact.

It was a day, Menke said, that many people didn't think would come. "We had been written off," he said.

More than 150 airlines have filed for bankruptcy since 1982. Some have vanished. For others, such as United and Delta, the journey has lasted more than three years.

Only an estimated one in three businesses emerge from bankruptcy.

Frontier is one of the survivors.

The Denver-based airline's path through Chapter 11 bankruptcy reorganization took less than 18 months from the time its leaders made the gut-wrenching decision that there was no way to avoid the turbulence.

"We were coming off a successful quarter, one of the best quarters we've had," Menke recalled of the period ending Sept. 30, 2007.

Frontier reported a consolidated net income of \$17.3 million. Load factors were at a record level. Revenues were up \$60 million from the same period in 2006.

New Airbuses were on the way. Lynx Aviation — Frontier's new subsidiary intended to reduce costs by flying short hops — was close to launch.



Frontier Airlines President and CEO
Sean E. Menke. (Kenneth D. Lyons |
The Denver Post)

"I thought the outlook was very stable, as far as airlines go," said Jeff Potter, who left Frontier on Sept. 6, 2007, after five years as chief executive.

Potter, now head of the vacation firm Exclusive Resorts, said he was confident Frontier would have "decent" December and March quarters.

He also had confidence in Menke, who was stepping into the CEO position. Menke joined Frontier in 1999, serving in marketing and as chief operating officer. He returned to Frontier at age 38 after a two-year stint with Air Canada.

"There was a need for Sean's leadership, and I knew Sean would bring different solutions to the table," said Sam Addoms, a Frontier founder who helped recruit Menke.

But as Menke took the helm, he was concerned.

Oil was eating up cash

Oil — the largest cost of operating an airline — was about \$68 a barrel, up from about \$50 a barrel in January 2007. Frontier's cash on hand, meanwhile, had shrunk from \$202.9 million on March 31, 2007, to \$181.1 million on Sept. 30, 2007.

"The storm clouds were coming," Menke said. "The industry was shaky."

Frontier had too much capacity, Menke said, and point-to-point flying "was really not working in some cases."

Southwest Airlines was nipping at Frontier's heels by carving a growing market share since returning to Denver in early 2006.

Southwest's cutthroat pricing kept Frontier, the No. 2 carrier at Denver International Airport, from raising fares to generate revenue.

In November and December 2007, with oil at more than \$83 a barrel, Menke eliminated unprofitable routes and funneled more flights through Denver.

"This is a chess game, and I needed all my chess pieces in Denver," Menke said.

He also cut 10 percent of the management jobs and 100 other positions, the first Frontier layoffs since the Sept. 11, 2001, attacks. The company Christmas party was canceled.

"I'm sure people looked at the September quarter and wondered why I was doing this," Menke said. "But we were going down into a hole I didn't like."

Oil prices continued a trek upward, nudging \$90 a barrel when 2008 was ushered in. "We just couldn't get in front of that," Christie said.

Menke added that "every \$1 increase in the price per gallon (of jet fuel) costs us \$5 million annually."

By January 2008, the Frontier Airlines Pilots Association knew the company was headed for turbulence.

Analysts hired by the union said there was too much cash locked up in aircraft. Though a former Frontier executive called the planes the company's "piggy bank," tighter credit markets made it increasingly difficult to tap into that asset.

John Stemmler, who has led the 700-member pilots union since 2001, said the report revealed that instead of having a healthy airline's cash on hand at about 15 percent of revenues, Frontier's was at 8 percent.

Credit was drying up. "Doors were getting slammed," Christie said.

The pressure was weighing on Menke. A self-described "man of faith," he said, "I would go to church and ask what I did to deserve this."

By February 2008, red flags about Frontier's financial situation began popping up at First Data Corp.

As Frontier's credit-card processor, the Greenwood Village-based company would be on the hook for any unfulfilled tickets purchased with credit cards if the airline were to quit flying.

For that reason, First Data closely monitors financial filings of Frontier and other airlines. Its officers grew alarmed about a burgeoning risk when Frontier's cash on hand shrank to \$170.4 million on Dec. 31, 2007.

During that quarter, Frontier's fuel expenses were \$117.5 million, compared with \$81.6 million during the same period in 2006.

Frontier also reported a record \$32 million loss for its fiscal third quarter and announced it would sell four of the 22 Airbuses it owned.

In February, First Data and Frontier officials met to discuss the situation.

"We told (Frontier) we had concerns, and they provided us with more information to alleviate our concerns," said Steve Citarella, First Data's senior vice president of credit and risk.

By the end of March, however, the situation had become dire. Frontier lost \$59.4 million for the year ending in March, and fuel prices had gone up 15 percent. As Frontier bled cash, talks with First Data continued.

Realizing that as CEO, he needed to know his options, Menke in March asked Marshall Huebner of Davis Polk, a New York law firm specializing in corporate transactions, what would be involved in a bankruptcy.

Huebner spent 45 minutes explaining the bankruptcy process. Menke did not know how soon he would need that information.

A fax from First Data

Shortly before 5 p.m. April 8, Menke got a phone call from First Data telling him a fax was on the way.

First Data, nervous about recent airline bankruptcies — ATA, Aloha and Skybus — told Frontier to provide collateral in the form of cash. On April 8, First Data put in writing for the first time that it needed cash — \$75.5 million — within three days.

It would withhold 50 percent of Frontier's credit-card receipts until reserves rose from \$54.5 million to \$130 million.

The move would have drained Frontier's cash in a few heartbeats, making it impossible to operate, Menke said.

"They tried to convince us that it was not needed," Citarella said. "We offered a number of options on how to get the additional collateral and in what form."

Tightening credit kept Frontier from borrowing against the \$225 million in aircraft equity, effectively emptying its so-called piggy bank. And oil had risen to \$115 a barrel.

The convergence of so many negatives was overwhelming. Menke recalls lying on the floor of his office, thinking, "What the hell is going on?"

Frontier officials pointedly cited First Data as the last straw forcing bankruptcy, and the company was publicly criticized for its role.

"I don't agree we forced them into bankruptcy," Citarella said. "We provided them with other options to come up with collateral in different time frames."

First Data "made a business decision, and I understand that," Menke said. "We tried to have them reverse that decision and weren't able to. That forced me to make a business decision."

Menke called Huebner, whose clients have included Ford Motor Co., the lenders to Enron and Polaroid, Citi bank, Delta Air Lines, the Federal Reserve Bank of New York and the U.S. Department of Treasury.

Huebner and his staff prepared mountains of documents for the bankruptcy filing. Many Davis Polk employees worked up to two nights. Huebner went two full days without sleep.

Before the papers were filed, the Frontier board needed to bless the bankruptcy. To avoid First Data's new terms on Friday, April 11, the bankruptcy had to be filed before midnight Eastern time Thursday with the U.S. Bankruptcy Court for the Southern District of New York.

The board decision had to be made before 10 p.m. in Denver.

Menke, a board member, notified the other eight members. They gathered in a small, spartan board room at Frontier's headquarters near DIA.

Bowls and plates of homemade and catered food filled the counters. At one point, 45 people — board members, senior staff and consultants — sat and stood silently as Menke and his team laid out the situation.

"We were dealing with business facts and emotion as well," Menke said.

Potter, the former CEO, was caught thousands of miles away.

"I was on a ship in the Galapagos Islands with my oldest son," said Potter, who was Exclusive Resorts host on a trip. "If I had known, I wouldn't have gone on the trip."

Potter had to borrow a big satellite phone and stand on top of the ship to join the meeting over a speaker.

"Sean likes to say that when he needed me most I was on a ship in the Galapagos watching birds and lizards," Potter said.

Late-night phone calls

It was clear to the board that bankruptcy was the best option to allow Frontier to re-invent itself while getting protection from creditors.

The board went into executive session and approved the filing about 9 p.m. Menke came out and told Christie to fly to New York to lay out the case in court the next morning.

Christie, senior vice president of finance at the time, retreated to his office to pore over the documents, all the while agonizing over a single thought: "I don't have a suit."

When he emerged, Christie was still worried about not having a suit for court when Menke calmed him down.

"I told him to call his wife, have her pack a suitcase and we would send a car to pick it up," Menke said.

Frontier executives called state and city officials to share the bankruptcy news. The response was supportive.

The bankruptcy produced "a combination of a little bit of shock, a little bit of sadness, a little bit of concern," said Kim Day, who had become DIA aviation director just a month before. "We love all of our airlines, but Frontier is our hometown carrier, and we have a lot of affection for them."

Stemmler, president of the Frontier Airlines Pilots Association, wasn't surprised when his phone rang at midnight with the news.

"The timing was really a shock, but the fact that we ended up there wasn't," Stemmler said.

Addoms, who stepped down as Frontier's board chairman when Menke arrived, said he had watched public financial statements, "but when the bankruptcy was filed, it was a total surprise to me."

First Data's Citarella said he talked with Menke the day before the filing, "and at no time did Sean or his staff indicate they were going to file for bankruptcy ... I picked up the paper the next day and I was quite surprised."

Christie made a red-eye flight to New York. He walked into Davis Polk's office to prepare for the first-day hearing in which he would explain Frontier's financial situation and what relief it was seeking.

"I could tell that Marshall had been sleeping on his floor," Christie said.

Added Huebner: "He didn't look much better than I did. We were pretty tired by then. We had done in 48 hours what usually takes six to 12 weeks."

Nonetheless, Christie stepped up, did what he needed to do in court — and he had his suit. Menke said Frontier's employees stepped up, too, which he credits with saving Frontier when everyone thought it would fail.

Wage cuts ratified

Also stepping up were the Frontier Airlines Pilots Association, the International Brotherhood of Teamsters and the dispatchers' Transportation Workers Union.

In May 2008, the pilots and dispatchers ratified temporary measures, including wage cuts of 14.5 percent and elimination of the 401(k) match.

"You couldn't blame (Frontier)," Stemmler said. "There were so many external factors pressing airlines, and they were in survival mode."

Included in the pressure was the upward spiral of oil prices, which jumped from \$107 in April 2008 to \$125 a barrel in May 2008. That meant another \$90 million in annualized costs for Frontier.

Frontier added a \$3 fee for food in flight and its first-bag fee and combed contracts and leases for savings.

Frontier cut routes as part of ending its contract with its regional carrier, Republic Airways. Savings were expected to be \$20 million a year.

Menke cut his salary by 20 percent and the salaries of 15 other officers by "significant amounts."

As June 2008 rolled in, Frontier's cash on hand dropped to \$59.3 million. The airline decided to keep 70 planes in its fleet and paid up all aircraft leases and financing pacts.

When Frontier filed for bankruptcy, one protection allowed it to suspend payments on its planes for 60 days. The airline decided before the deadline to affirm the leases and contracts.

Squeezing every drop of costly fuel, Frontier replaced cloth seats with lighter leather, loaded enough beverages for a one-way flight and taxied planes on one engine when it could.

Frontier wasn't alone in being hit hard. Most carriers instituted bag fees — the beginning of a wave of a la carte charges — to counteract the skyrocketing fuel costs that consumed as much as 40 percent of their operational budgets.

Seven planes were retired, two were sold and 21 daily Denver departures were chopped.

Between the bankruptcy filing in April and November 2008, Frontier also cut 600 jobs in Denver and New Mexico, most through attrition, early retirement and voluntary leaves.

About 155 were pilots, who mostly understood "something had to give," Stemmler said.

Though there was pushback from the International Brotherhood of Teamsters, Frontier workers agreed to more than \$10 million in temporary pay cuts Menke said were needed to find debtor-in-possession financing.

Frontier employed 6,115 staff before bankruptcy. Today, it's about 4,800.

After that mid-July evening when Menke and Christie acknowledged over beers that the company would have to close, Menke had returned the next morning with a few more ideas up his sleeve.

With Menke's dry-erase board showing the wolf at the door, Frontier met with state and Denver officials to ask for relief on items such as sales tax.

Neither could do much, constrained by tight budgets and the need to move financial issues through the legislature or City Council. "They had to be realistic on what they could and could not do," Menke said.

DIA did give some relief by taking back gates, ticket-counter space and unneeded space on Concourse A.

But even those concessions failed to stem the rising tide.

Such short-term fixes helped the airline limp along, although there would be more than another day or two when Menke and Christie thought the end was at hand, especially as oil neared \$150 a barrel.

Then on July 25, 2008, Frontier got a vote of confidence. Perseus LLC, a private Washington, D.C.-based investment firm, made a \$75 million commitment for debtor-in-possession financing. The loan would allow Frontier to operate while it restructured.

Then a group of three companies — Republic Airways Holdings, Credit Suisse Securities and AQR Capital — offered a similar deal with fewer restrictions and lower costs.

At the most basic level, Republic was protecting its investment, said chief executive Bryan Bedford. Republic and Frontier agreed to end Republic's regional contract. As a result, Republic claimed damages in excess of \$200 million against Frontier.

"By providing the DIP (debtor-in-possession financing), we would be staying in the game," Bedford said, "and if they were successful, we would be."

A few days later, Frontier received court approval to sell six aircraft to a Russian firm for \$165 million. The deal would discharge \$97.7 million of Frontier's debt and provide Frontier with \$67.3 million in cash.

Through the fall of 2008, Frontier firmed up long-term contracts with its three unions. The agreements

included "snapback" provisions that provide relief for several years before reverting to previous levels.

Frontier also canceled a \$25 million maintenance hangar in Colorado Springs and cut sports sponsorships.

Going the distance

Frontier employees sacrificed family time and slogged through stress. Menke and Christie, both avid runners, ran to clear their heads.

"There were a lot of miles," said Christie.

At times, Christie said the best stress reliever was to go home and spend time with his wife and two young daughters. When he was home, he said, they had his total attention.

Menke, with three boys under 6, said he missed bathtime and bedtime reading, duties his wife took on.

It wasn't until December 2008 when cash from the Russian aircraft sale started flowing that Menke and Christie felt Frontier was no longer on the edge of a precipice.

"I remember thinking, 'Everyone can enjoy Christmas,'" Menke said.

The turning tide continued in December when Frontier reported a consolidated net profit of \$2.9 million and an operating profit of \$2.5 million in November 2008. It was the start of a 10-month run of profit.

Frontier found more than \$98 million in annual cost savings during the first 12 months of bankruptcy.

Republic's Bedford was watching, and was impressed. In mid-March, with the other two lenders skittish over the economy, Republic reworked Frontier's debtor-in-possession financing.

Menke hit the road, looking for a reorganization plan sponsor. Frontier had entered bankruptcy so quickly it hadn't secured a backer.

"There were a lot of guys kicking the tires back in March," Bedford said.

By April, Bedford was talking to Frontier about a formal reorganization plan. In late June, Republic signed on to purchase 100 percent of Frontier's equity for \$108.75 million.

The bankruptcy court approved Republic's plan in July but left the door open for 30 days for other investors. Analysts were doubtful another suitor would step forward, citing a weak airline market and belief that if another bidder existed, it would have already emerged.

But Southwest, DIA's third-largest airline, stunned the industry by saying it would bid. The discount carrier had been looking at Frontier since it first filed for bankruptcy.

"We evaluated Frontier several times and it was just not quite the right time to pull the trigger," said Bob Jordan, Southwest's executive vice president of strategy and planning.

In late July, Southwest offered \$170 million for Frontier.

The competing bids set up a tense scenario in Denver — Republic had committed to keeping Frontier as a standalone subsidiary with its name and brand intact; Southwest wanted to absorb it.

On Aug. 13, a bankruptcy auction was held at Frontier's New York attorneys' office.

Frontier leadership was in one conference room, with Southwest, Republic and the unsecured-creditors committee in others. Huebner, Frontier's attorney, shuttled among the rooms.

It was up to Frontier's board to select the highest and best bid, in consultation with the unsecured-creditors committee.

"There was a lot of time to talk and eat doughnuts and strategize," Southwest's Jordan said.

The day-long auction ended with acceptance of Republic's offer. It was best, Menke said, because it had received Department of Justice antitrust review, waived what Frontier owed Republic, had the highest return for creditors and was most likely to close.

Southwest's offer still needed to pass the Department of Justice and hinged on its pilots union reaching a seniority integration agreement with Frontier's pilots union.

"We were not going to risk our relationship with our employees — that was the tipping point," Jordan said.

Many investors and creditors took big hits on the deal. For example, Stemmler said he owned 3,000 shares, bought for as much as \$23 per share, but will receive 17.2 cents per share. The pilots union had a \$29 million claim for concessions and will be compensated only \$5 million.

The negotiators flew back to Denver, greeted by a throng of 200 employees and a water cannon salute. Menke said it made him realize he'd been thinking of the best business option and hadn't considered employees' emotional connection.

Frontier employees shared Menke's feelings of anger, frustration and frequent doubts along the 18-month bankruptcy journey.

"The naysayers didn't know just how much I hate to lose," Menke said.

Frontier was like "the little engine that could," Huebner said. "They just sort of hunkered down, pulled through and beat all the odds."

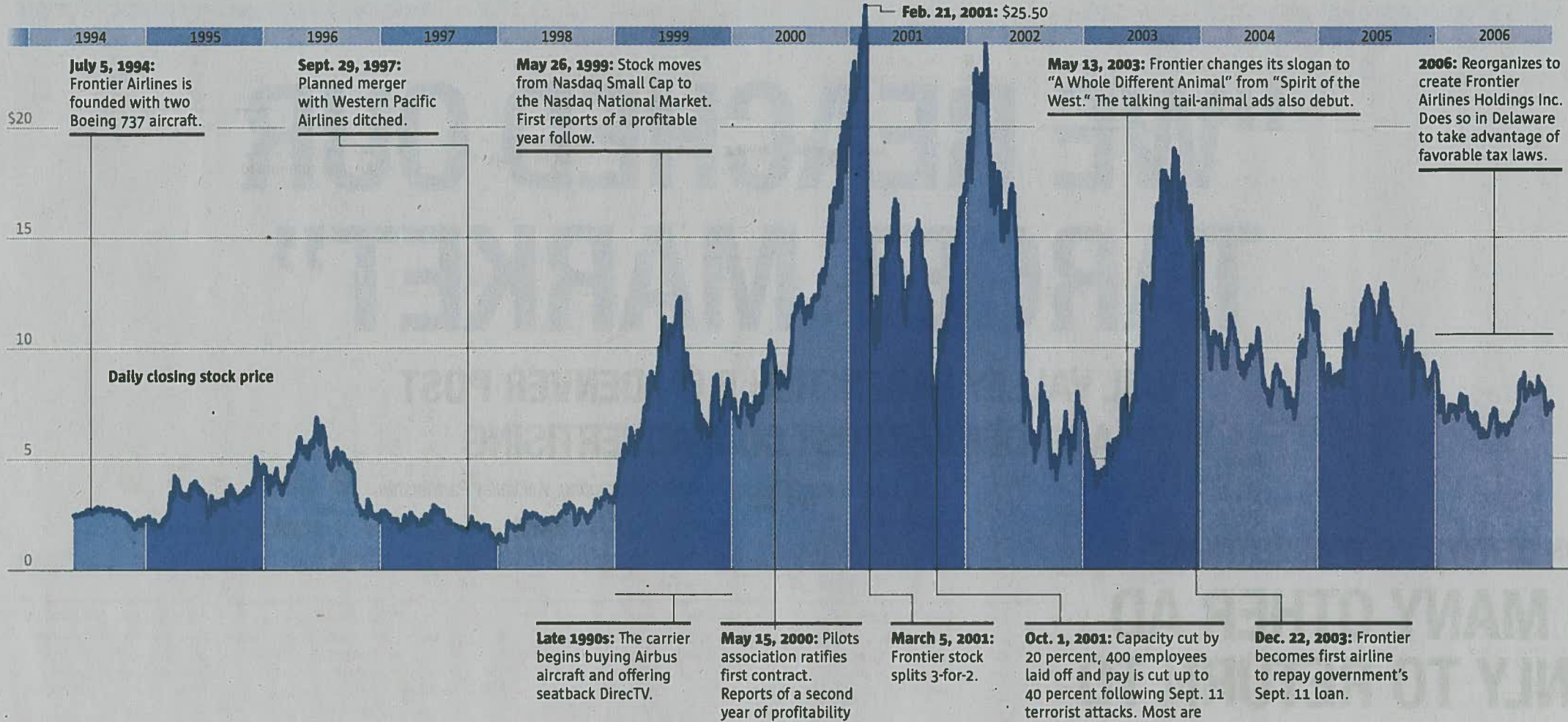
The bankruptcy, said Frontier founder Addoms, "has been a very difficult thing to witness."

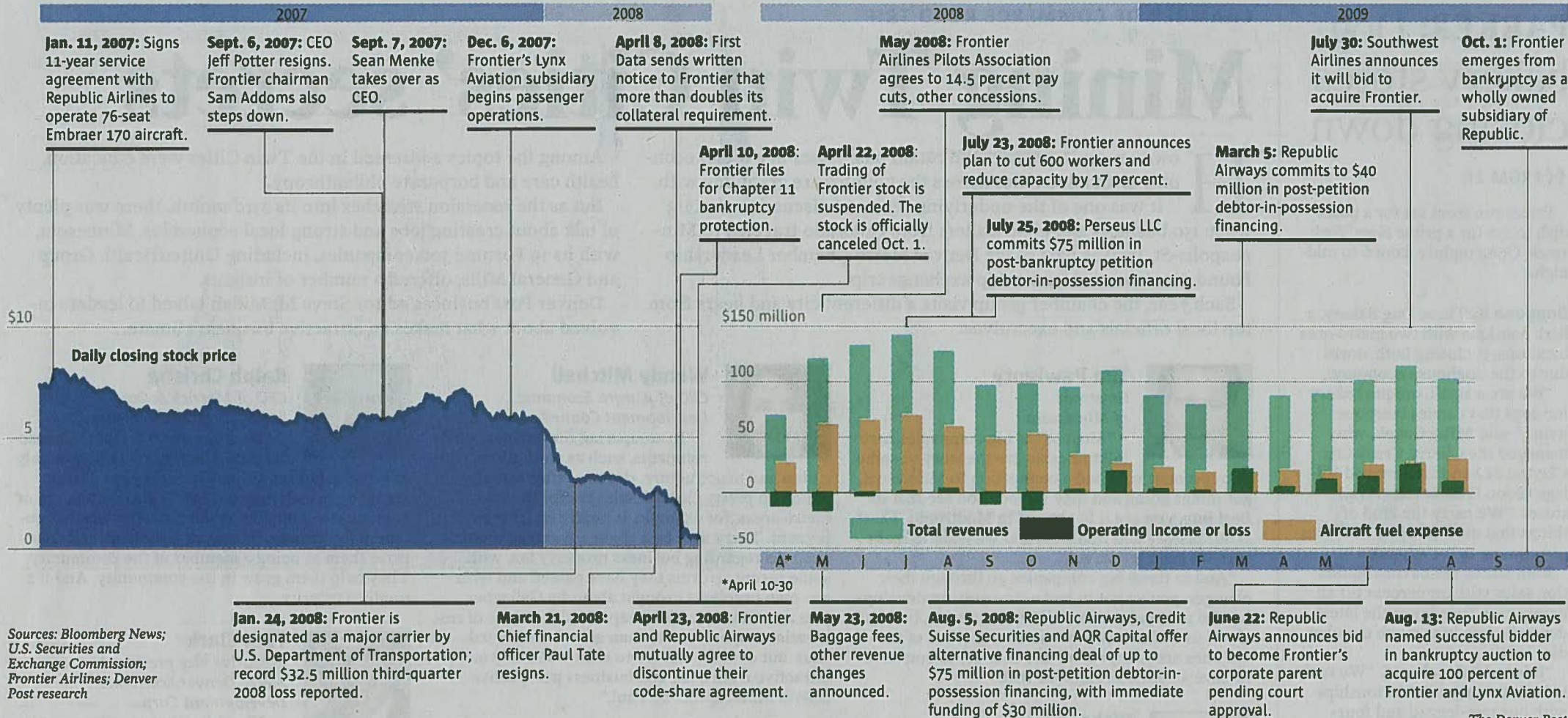
The thing that "just stuns me," Addoms said, "is a relatively unproven group of people were able to be pulled together under Sean's leadership, and no one believed they could do it."

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