American Financial Advisors, LLC
Strategic Financial Guidance

Tuesday, November 7, 2006

Delta Pilots -- $2.1B Claim Questions

Dear All,

What follows is a discussion of the upcoming near term decision to either "pre-sell" -- or hold -- your allocation of Delta stock that will be forthcoming in 2007.

Your decision could mean the difference in tens of thousands of dollars in your pocket -- or not -- due to the choice to sell/hold the stock -- or the decision to purchase other assets with those dollars.

Any taxation and/or timing of the assets received could also make a significant difference in what you keep -- or give back -- to Uncle Sam.

Hopefully, ALPA will allocate more time and money to answer the trickier questions many pilots will -- or should be asking -- especially in the tax arena -- where various options can be forged with forethought and proper planning.

There are many considerations and background information the Delta pilots could benefit from in order to make an informed decision. Our team at American Financial Advisors (AFA) will address as many issues as possible and send additional information over the next couple weeks via e-mail and this forum -- if/when appropriate.

ALPA's ***ADC Dispatch 06-06*** presented some initial questions that we felt were well-written and balanced. However, there are still important unanswered questions the pilot group needs to know to make a prudent choice that considers all possibilities. There is also time for ALPA to pursue a couple "taxation" paths that would be helpful to every pilot.

The pilot group needs professional guidance and advice to make a sound decision. What are pilots paying dues for if not to receive decent advice they can trust and take to the bank?

Since ALPA didn't oppose the termination of the pension plan, one might think worthwhile professional guidance provided by the union might be warranted on this next round of decisions. Doesn't termination of a pension plan fall into the arena of "financial advice" and definitive action on our behalf? Was that decision insulated from the "liability" category?

The reason generally put forth to not provide "financial advice" is that personal liability is too great for each ALPA rep. Yet it was OK to not oppose termination of the pension plan for both the active and retired pilots.

ALPA doesn't represent our retired Delta Captains after 25-30+ years of faithful service and paying dues, but it had the authority to negotiate away their earned benefits. That <u>action</u> would appear to be "financial advice" of some type.

Everything we have ever been taught about ethics, morals, integrity, trust, values and honor -- tells us termination of the Delta, United and USAir pilot pension plans was wrong.

I can think of no greater threat or financial liability to the airline pilot's profession than a 50% pay cut and termination of the Delta Pilot pension plan.

My guess is there were some very surprised elephants in the room when they discovered our pension plan was being terminated.

At what greater inflection point do you break out the $50 million War Chest in Washington and fight to protect the earned and deserved benefits of your members?

We flushed decades of hard work accomplished by thousands of dedicated ALPA reps, officers, committee members, and volunteers. Where was ALPA National? Where was the shoulder-to-shoulder strength of the national brotherhood when it was needed most? Soon to be Ex-President Duane Woerth was voted out of office recently for good reasons.

What deep rooted message did Delta send loud and clear to the non-contract employees? You didn't need a union to save your pension. And those who had the money, resources and professional advisors that come with a union weren't so lucky. Coincidence? Not.

In the final analysis, we are reminded capitalism has both a bright and dark side. In the case of the Delta pilots, many are paying a steeper price than others. As has always been the case in the airline industry, most of the good or bad deals each pilot experiences during a career have been due to a combination of prior decisions made years before and the timing or position of your particular seat at that point in time.

Maybe the pilot groups at American and Southwest figured this out long ago - since they both retire with the largest retirement nest eggs in the industry and have retained their full pension benefits.

But that's another article.

Thus, for those who receive our e-mails/ information, we offer the following discussion of what is known to date. Given the significance of any decision by the current MEC, we encourage all pilots to call your ALPA reps to request pertinent information and further clarification of the issues.

A large number of the pilots truly feel they are being left in the dark on these important decisions. At American Financial, we are trying our best to help fill the communication gap with sensible advice and the same guidance we would offer our own family members.

The union has already addressed some of the following items, but we should receive additional communication in a detailed, official manner that appears in writing for all parties to have a chance to consider or weigh. Thus, this article is intended to be helpful to all Delta pilots - and maybe offer items not yet considered by the pilot group or the union.

Here's the key issues/questions and our recommendations for further discussion before the "**November 30th decision window**" closes.

Respectfully, Mike Stark and the American Financial Advisors Staff

---

(1) <u>The "Pre-Sell" Option - Likely Your Best Choice</u>

The most prudent move with the <u>most flexibility</u> is to "**pre-sell**" your claim for two simple reasons. You will have cash in hand to do any other transaction with the money and <u>reduce the risk</u> tied to a single asset, company, or industry.

From a pure risk stand point, your job as an airline pilot already places your "total investment portfolio" or risk profile -- with enough marbles in the airline sector. There is a valid argument that you shouldn't own <u>any</u> airline stock - since you have enough exposure to the downside risks of the airline industry already. There is no reason to "pile on" that risk with retirement dollars allocated to an airline stock as well.

However, some may choose to keep their allocation of Delta stock because they believe it will "take-off" and could certainly trade or "open" at a higher price than the pre-sale offering price. One viable option is if you believe it is poised to go higher, buy it in the open market with cash from the "pre-sale".

Currently, the valuation for "Delta" in the market is 37 cents on the dollar. It is very likely the "pre-sale" offering could bring 30-35 cents -- or more -- from investors willing to accept the risk and potential gains, if they thought Delta might bring 40-50 cents on the dollar further down the road.

Yes, you may miss some portion of the upside price on Delta stock vs. the pre-sale offering price, but you also allow yourself the opportunity to purchase any other investment vehicle that has similar or greater upside potential and may carry less associated risk.

Delta stock might trade lower than the pre-sale price. Or it might open higher, but then drop, due to any number of market or economic forces in play at the time. No one knows.

Case in point: UAL's initial offering price in the months prior to their exit from BK was predicted by "experts" to be offered at $15/share. It opened the first day at over $40/share and closed just under $36. The estimate of $15/share wasn't even close.

Longer term, you might buy shares of Delta stock during any pullback, if the future looks promising and Delta does emerge as a strong competitor, with less debt and better revenue numbers. But you might also have already purchased other investments that surpassed or kept pace with the "value" of the Delta shares. Your cash might already be on better horses out of the gate -- outside the airline industry.

There is no perfect answer here, since the valuation of the stock is a complete unknown 6-12 months from now. But you grant yourself the most flexibility and a lower risk profile if you pre-sell your allocation to position yourself to be more diversified in various other investment vehicle(s).

For example, any United pilot who pre-sold his UAL shares at $24 and bought shares of Google in February is a temporary genius if the shares go to $600. The shares have gone from $340 to $480 for a gain of $140/share or 41% since February. The United pilot should set a stop loss limit on Google and be wise enough to get out -- and invest in something better - like cattle sperm or a llama farm - to be sure to lock in those gains for retirement.

<u>Bottom line</u>:

Any airline pilot already has enough risk associated with the job. Pinning additional future hopes on an airline stock would be taking on even more risk -- for any number of negative reasons most have been deeply affected by already.

The track record and money made on owning allocations of Delta stock over the years has been a matter of luck and timing. Some investors have made a killing at certain times and some have been burned badly - especially the employees. We prefer to take the cash and have the flexibility to <u>diversify</u> your nest egg and invest in any asset -- Delta or otherwise.

(2) Even if the *Athena Group* shops the "pre-sale" claim and has buyers -- it doesn't mean the entire claim would be liquidated. Those who decide to "pre-sell" could still end up with some combination of both cash and stock. If so, it would make sense to take the stock in the "taxable" basket and fill up the tax-deferred baskets (DC/401k) with the cash -- as much as possible.

Why? Because you could luck out. Let's say the stock does well and is held for 12 months. Then you sell it. Your taxation of the long term capital gains would be 15% instead of the more ominous 25-35% that many will pay on the taxable portion of the cash -- based on your normal income tax rates in 2006, 2007, and 2008.

So -- if forced to take stock -- let's put some thought into which combination would be most beneficial to reduce taxes.

(3) If you keep the stock and sell in the first 12 months, are you prepared to pay short-term capital gains at 25-35% (normal income tax bracket) vs. long term capital gains if you hold the stock one year or longer?

What risks are associated with holding the stock longer term?

Delta has never lost money in a year that ended with 7, 8, or 9 - but this is primarily a function of the airline industry cycle versus Delta's prowess to overcome the obstacles to profitability in the industry.

We would not use this particular "past history" to make a decision, but it can't be discounted that Delta stock has a good chance to gain value once we exit bankruptcy during this specific time period of 2007-2009.

Profits could be substantial - or there could be significant downside risk as well. This must be considered part of your "roll of the dice" decision on keeping the stock - but as we pointed out earlier - it might simply be best to buy the stock with some of the cash if the future appears brighter.

(4) The DC Plan/401k Contribution Option

Part of the distribution of the proceeds from the $2.1B Claim is projected to be allowed to be contributed to the pilot's DC Plan - up to the IRS's Federal 415(c) limit for 2007 of $45,000. An additional $5000 may be sheltered in 2006, 2007 and 2008 if you will be 50 years of age or older, anytime in 2006.

The union is pursuing the option to backfill 2006 - up to the Federal limit of $44,000 for 2006 + $5000 Catch-up = $49,000 - for the DC Plan and 401k. Additionally, the pilots may also be allowed to contribute the max in 2008 as the $650M note is paid out.

Thus, a pilot, 50 years of age or older could ultimately put $149,000 into the combined tax deferred vehicles of the 401k and DC plan for years 2006-2008. For anyone under 50 it would be $15,000 less or $134,000.

{For clarification: The IRS 415(c) limits of $44K in 2006 and $45K in 2007/8 include <u>all</u> contributions by <u>both</u> the employer and the employee into the 401k and the DC plan.}

An additional benefit of the backfill option would be if the distributions were allowed to fund the Traditional 401k for any pilot who may have been unable to max out their 2006 contributions due to the adjustments necessary with a significant cut in pay in 2006.

It might also be worth considering the option for a portion of the Claim dollars be used to fund the Roth 401k in some cases. These would be the years (2006-2008) where pilots who are in the lower tax brackets might consider funding the Roth 401k.

Normally, we would not recommend funding the new option of a Roth 401k if you are in the highest tax brackets. There is no reason to pay high taxes now - to get tax free growth -- when you may be able to do a Roth Conversion - post retirement - in a lower tax bracket. No one can predict future tax rates - but an obvious general rule of thumb is to never pay taxes any sooner than you have to - especially in the highest brackets.

Many of our current retired Captain clients are doing this now. They had a Traditional 401K while working which they transferred to a normal Rollover IRAs when they retired. They are now converting some of those dollars to a Roth IRA -- at much lower tax rates (10-20% taxation versus 30+%) than if they had done a Roth 401k while working.

By doing the Roth Conversion they will accomplish three worthwhile goals:

(a) Establish a new Roth IRA that enjoys tax free growth for the rest of their lives

(b) Place those dollars in an <u>exempt</u> status from the future requirements of Minimum Required Distributions (MRD) at 70 ½.

(c) Be allowed to pass the Roth IRA on to future generations - who would reap the benefits of tax free growth indefinitely.

Had the Roth 401k been available to these retired pilots a couple years ago, funding the Roth 401k would have been a mistake in most cases, since the tax they would have paid up front would have been higher than the tax they will now pay for a Roth Conversion - in their lower, current tax brackets.

(5) <u>Retirement Dollars - or Not?</u>

One concern we have is the characterization of the $2.1B Claim dollars. We know the union negotiated the claim as a "*general non-priority unsecured claim. in respect of concessions made by ALPA and savings to the Company resulting from achievement of consensual modifications to the PWA" under the terms of Letter 7"*.

In other words, the claim is not, repeat, is not -- replacing lost retirement benefits or termination of the pension plan. The PBGC may disagree - but that's the legal stance being put forth by ALPA and Delta with their specific language in LOA 51.

We don't disagree with this definition of these dollars or why the unsecured claim is being entertained by the Company. Our concern rests with how a current or future divorced pilot may have to defend/answer to divorce proceedings, a judge or court, or the stipulations of a QDRO (Qualified Domestic Relations Order) with respect to "retirement" dollars and the division of marital assets.

Without getting into the myriad of possibilities here, it might be wise for pilots in this situation to consider whether to place their portion of the claim into an allowed "retirement vehicle" like the DC Plan or keep all proceeds in a brokerage account or other investment - outside the category of "retirement" assets. A discussion with an attorney might be a good investment if you find yourself in this possible Catch-22. You're being told these are not "retirement" dollars but there are those who might see it differently.

We have no "special" knowledge in this arena, but part of our job as financial advisors is to look ahead at potential pitfalls that others may not see or consider - present day.

(6) <u>What Happened at United?</u>

Some background on UAL's pricing and the activity of their stock since exiting bankruptcy might be useful guidance for the Delta pilots - or a worthwhile example of the obvious fluctuations of the industry's fortune/misfortune most of us know well.

Due to the similarities in revenue and valuation of the legacy carriers it makes sense to look at the stock of United and AMR as a barometer for where Delta may trade upon exiting BK.

After 3 years and 51 days, UAL exited Chapter 11 on Wednesday, February 1st of this year - 2006.

United's stock; (Ticker: **UAUA**) traded on the NASDAQ the next day and opened at $40.83. Closing price on 2/2/2006 was $35.89. Since exiting BK in February the stock has fluctuated between a low of $21.90 in August and a high of $43 back in March. The 50 and 200 day moving average has ranged from $29-32/share. Closing price this past Friday -- $34.77.

By comparison, American (Ticker: **AMR**) got down close to $1 in March 2003 and has recovered back into the high $20's lately -- with the 50 and 200 day moving averages around $24/share. Friday's close: $27.22.

Where did the UAL numbers originate for the pre-sale price of 24 cents on the dollar?

United put together exit financing of $3 billion at this time last year in 2005. After 3+ years and over $300 million in attorney's fees, United's management team (not leadership team) -- came up with their restructuring plan and set their exit date from Chapter 11 on February 1, 2006. The lenders who agreed to provide the exit financing were led by JP Morgan, Cititgroup, and GE Capital. It was an **all-debt deal** - which leveraged every asset UAL owns as collateral.

At the time, <u>unsecured</u> claim holders at UAL - like the pilots -- were expected to only receive 4-8 cents on the dollar. This is where the "6 cents on the dollar" floor came from with respect to UAL's MEC authorization for their "pre-sale".

Concurrently, UAL's bonds were still trading at 24-28 cents on the dollar -

which in retrospect was potentially way out of whack or absurd - but due solely to speculation.

UAL exited BK with approximately $20 billion in debt, yet still commanded 24 cents on the dollar. UAL remains almost fully leveraged on a debt-to-equity basis - which was surprising after 3 ½ years in BK.

The fact that the bonds were bringing 24-28 cents on the dollar is why those who pre-sold at United received 24 cents on the dollar versus the initial estimate of 4-8 cents.

Delta's MEC has set a floor - or lowest acceptable offer to pre-sell at -- "25 cents on the dollar". Thus, an apples-to-apples comparison between UAL & Delta would indicate that the value of a "pre-sale" at Delta would bring a higher price from the market place.

Similar to Delta's 30-day decision window, the United pilots were given a very short window to decide to pre-sell their individual claim. Many felt they did not have the time or information required to make the "best" decision. Most of the members of the UAL MEC pre-sold their allocated positions. Many of the line pilots did not. I don't know the breakdown of those who pre-sold or not at United.

Did the United MEC have the best information? Probably as good as anyone. Did they share that knowledge or communicate very well to give all United pilots a sound basis for their decision? It does not appear so if you talk with any line pilots at United.

Many pilots who did not pre-sell were sitting with less value for the allocation than those who pre-sold. Numbers that have been quoted say the pilots who sold later received a lesser value around 17 cents on the dollar or 30% less value for their shares than those who pre-sold their allocation.

Ultimately, what did UAL accomplish to place themselves in a better competitive position by filing for Chapter 11 protection? Very little. Except they shed $7 billion in costs - a majority from labor -- and terminated <u>all</u> employee pension plans. Which may be one reason why they recently hired Goldman Sachs to "shop" their opportunities in the industry. Read this move as: "For Sale -- Whole House or Any Valuable Pieces". That's a whole other discussion/article.

Delta is forecast to exit BK with approximately $10 billion in debt - down from $20-22 billion. In the past 12 months, Delta's annual revenue has increased to $16.7B. This obviously positions Delta with a much better debt to equity ratio than United - in the neighborhood of where we operated in the 1980-90's - at 60-65% leveraged. This is a very reasonable and acceptable range for any corporation of similar structure/size.

Thus, the offer on the "pre-sale" of the $2.1B claim should command a higher premium for Delta's stock - which is why the Delta MEC and ALPA financial advisors set the floor on any "pre-sale" at 25 cents on the dollar versus 6 cents over at United.

It is likely or hopeful -- the "market" will offer a pre-sale price anywhere between 30-35 cents on the dollar -- or higher -- based solely on the markets' valuation of Delta's superior position vs. UAL's numbers prior to and upon exit from Chapter 11.

Or as ALPA ***ADC Dispatch 06-06*** pointed out, a purchase of the pilot's portion of the equity could be part of a hedge funds' greater strategy to sell Delta stock long/short against other hedged positions in a market place consisting of many non-correlated assets.

One wild card factor remains that may benefit the movement of Delta stock and the overall success of Delta's exit from bankruptcy. UAL's business plan counts on $50 oil. Delta's plan is based on $60 oil. Either way, Delta has increased their chances for "success" with a more conservative estimate of their ability to cover the future volatility of oil prices.

(7) <u>401k versus DC Plan Contributions</u>

If a pilot starts putting 401k contributions into his account in January, how will the DC Plan contributions be handled and what considerations for any Social Security taxes paid on those dollars are pertinent?

Is there any tax advantage to refunding the initial 401k contributions for 2007 to the pilots and putting as many dollars from the Claim as possible into the DC Plan and 401k? ALPA's tax/financial advisors should offer the pilot group their best assessment of this issue - whether one course of action is more favorable -- and why or why not.

What happens to the company's 9% allocation to the DC Plan and 2% to the 401k if a pilot maxes out the DC/401k plans with dollars from the $2.1B Claim?

If we are allowed to put the max allowable into the 401k/DC Plan for 2006, 2007 and 2008, in order to shelter as much as possible from high taxes, can we use a deferred compensation option to suspend the company's 11% contribution in 2007/2008 and then put 22% (9% DC + 2% 401k) in the DC Plan and 401k in 2009/2010?

Are the tax savings worth the possible loss to opportunity cost?

Has anyone considered this option for the pilots' overall tax bite and potential benefits?

What other deferred compensation options might be available to the pilots with these dollars?

Would the Company be willing to compensate the pilots the 11% for 2007/2008 in some other manner that is not taxable? More vacations days?

(8) Employees on Military Leave

While researching the latest IRS code and language for this article, I came across something I was not aware of and this is as good a spot as any to put out the information.

There was a rule change in 2005 by the IRS that allowed contributions to retirement plans for individuals on military leave from their jobs. Employer plan amendments made after May 31, 2005 are required to conform to the new rules.

I don't know how many Delta pilots or employees may be affected by this change but it would worth while to research and ensure you are getting all contributions to your retirement accounts that may be legally due. If the company is not paying you the dollars owed yet, you have opportunity costs that shouln't be ignored.

Remember, historically the best months of the year to be invested in the markets over the past 100 years have been October-April vs. May-September -- thus the old adage "sell in May and go away". If you have money sitting over at Payroll -- owed to you during service to your country -- get those dollars into your account now, not later.

(9) Holding Period If You Keep the Stock?

Will there be a holding period or moratorium on selling for any length of time if you decide to take the stock? We have heard stories of restrictions when the United pilots received their allocations. Our reading of the documents shows that if the stock went into the 401k, etc.at United, you were able to sell the stock and invest in any other funds without any restrictions. I wasn't able to get a good answer on this subject. Some clarification from ALPA would be appreciated on this issue to clear up any rumors.

(10) If you don't exercise the pre-sale option, and hold the stock -- can a pilot sell the stock 1-3 years from now and still put those dollars in a 401k/DC

Plan -- or equivalent -- up to the max for that year? I don't have the answer on this one yet but am trying to get reliable answers.

(11) If you don't "pre-sell" and retire before you do sell, can you still place those dollars in a retirement account?

(12) Are the pilots in the PC3 category who are 53 or older -- and still working -- going to be told how to expect the $650M note will be divided up before they make their decision on the pre-sale? And if not, why not?

(13) The original matrix of DC contributions was "OK" while we still had a Defined Benefit plan in place, but how do we compensate the more senior pilots who don't have nearly as much time to make up the lost value of their earned pension?

Do we owe the pilots money towards their DC Plan who weren't receiving any contributions into those accounts until the recent October 15th distribution. Some consideration should be placed in this area since these pilots don't have the "time value of money" on their side.

(14) Why is the window so tight for the "pre-sale" decision? Are we being patient in shopping the claim as the valuation of "Delta" has been increasing in the market place due to a number of restructuring moves this far and increasing revenue.

(15) Why are we not doing road shows for one of the most important decisions the pilots will be asked to make?

We will send updates between now and November 30th if anything else changes or comes to light of importance and changes our opinion/recommendations.

We hope this discussion has been helpful in some manner.

Please call or e-mail us anytime with any questions.

Respectfully, Mike Stark

Unsubscribe from Newsletter

Visit us at www.afainvestments.com

American Financial Advisors, LLC • 2551 Roswell Road, Suite 310 • Marietta, GA 30062