

Will Investors Board Revived Delta?

Bankruptcy Exit Puts Airline on Firm Footing, But Shares Face Pressure

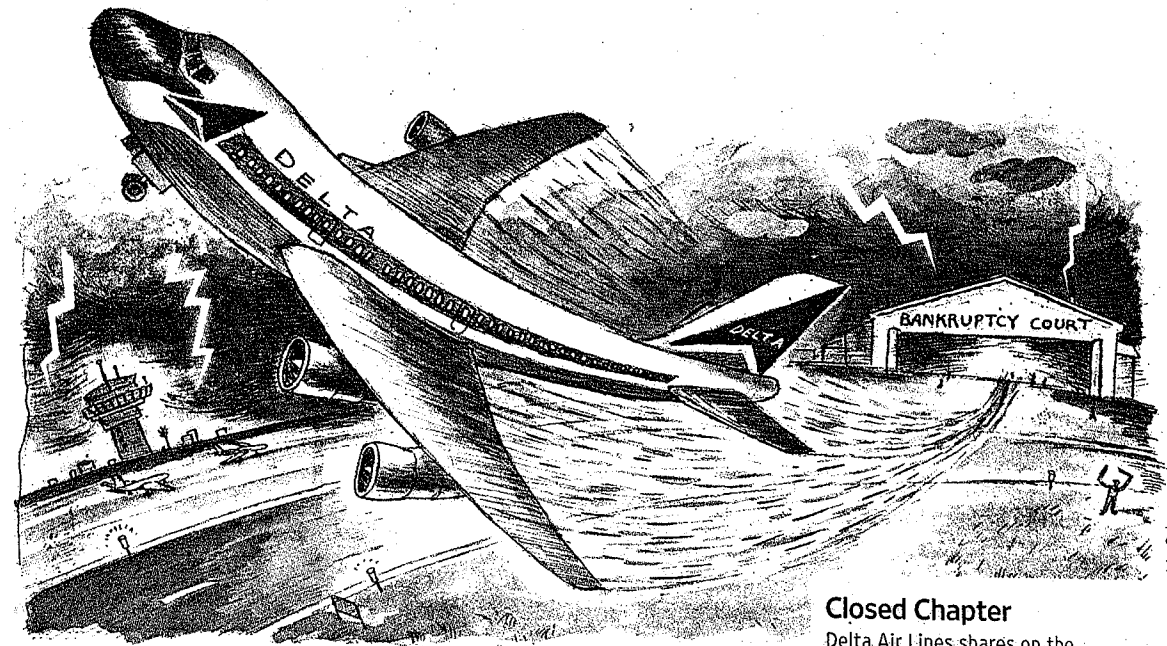
WHEN DELTA AIR LINES Inc. formally emerged from bankruptcy yesterday, it marked the end of a 19-month restructuring process that has enabled the carrier to fly high recently.

By slashing \$3 billion in annual costs and transferring excess capacity from unprofitable domestic routes to promising international destinations, the carrier successfully repositioned itself to tap strong demand for air travel over the past year. The formerly money-losing airline has posted an operating profit during each of the past four quarters.

But don't expect the airline's new shares, which will replace those that traded over the counter, to take off when Delta begins trading again Thursday on the New York Stock Exchange.

While Delta recently dismissed concerns by rival carriers, such as Southwest Airlines Co. and Continental Airlines Inc., that consumer demand has begun flagging, investors remain skeptical of many airline stocks at a time when the forecast for the U.S. economy is cloudy. Slower economic growth could hurt profits and tempt all carriers to cut fares, reversing an unusually long spell of pricing unity in the U.S. airline industry.

Delta's new shares, meanwhile, already are trading on a "when-issued"



basis at levels suggesting that the valuation placed on the carrier by its financial advisers may be higher than what would-be buyers of its stock are immediately willing to pay.

When Delta filed its final reorganization plan with a New York bankruptcy court in December, advisers suggested the airline, upon exiting from Chapter 11, would be valued at between \$9.4 billion and \$12 billion. That represents between \$23.50 and \$30 for each of the 400 million shares to be issued.

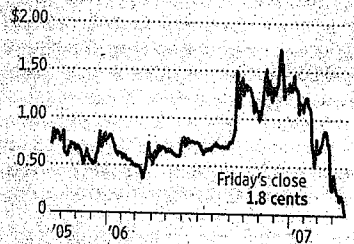
Even the lower end of that range would give Delta the second-highest market value in the U.S. airline industry, after Southwest, and a price-to-earnings ratio second to none, based on the airline's net income forecast of \$456 million for 2007.

Delta's when-issued stock, though, closed last week's trading at just \$20.91 a share and yesterday ended the session at \$20.45. Those when-issued shares currently trade at almost 18 times projected per-share earnings for this year, cheaper than Southwest's price/earnings ratio but richer than most of its other rivals.

Last week, Edward H. Bastian, the company's chief financial officer, said that management is comfortable with the prospects for Delta's share price and recognized that a market capitalization of \$10 billion or more "would be fully valued." An initial surge in the share price, Mr. Bastian added, would be an "unnatural build," considering that about 150,000 of the shares to be

Closed Chapter

Delta Air Lines shares on the Pink Sheets since declaring bankruptcy on Sept. 14, 2005



Source: FactSet Research Systems

issued won't begin trading until the airline completes litigation with a minority of creditors who are still disputing the value of their claims against the
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Dow Industrials Fall 58.03, Ending Late-April Streak

By PETER A. MCKAY

THE STOCK MARKET roared like a lion in April but went out like a lamb, as an early rally on the last trading day of the month evaporated.

Economic data were mixed, and some investors decided to take profits after the recent records in the Dow Jones Industrial Average. On the bright side,

crude-oil prices fell due to refinery outages, which could crimp demand for crude oil in the weeks ahead. At its high for the day, the Dow

measures like the S&P. Some Wall Street pros have fretted over that trend, saying that widespread strength among different sectors would be a more comforting sign that the market could move higher in the weeks ahead.

"We're very concerned" about the potential for a prolonged pullback, said David James, senior vice president of data firm James Investment Research. "The indicators that we follow right now are sending neutral signals, at best."

Mr. James pointed to last week's government report showing that the U.S. economy grew 1.3% in the first quarter, below expectations and the lowest rate in four years. He also said the Federal Reserve's hold-steady policy on interest rates has gradually lessened the amount of money in circulation throughout the economy, limiting the amount of cash available to firms

MONDAY'S MARKETS

DJIA	13062.91	▼ 58.03
Nasdaq	2525.09	▼ 32.12
Oil/barrel	\$65.71	▼ 0.75
10-year Treasury Price	▲ 17/32	



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Will Investors Come Fly With Revived Delta?

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pre-bankruptcy Delta.

Since that process could take months and continue to drag on Delta's share price, some creditors who would have been issued the company's new shares instead opted to sell before they ever received them. Last month, for instance, more than 90% of the airline's pilots completed the sale of about \$1.16 billion in claims against the airline to investors more willing to wait for long-term growth of the stock.

Selling Pressure

And other creditors are expected to follow suit. "There's going to be some pretty big sell pressure on the stock because there will be lots of [creditors] looking for liquidity after being locked in for so long," said Bill Mann, an analyst at the Motley Fool, an online investment-advisory firm based in Alexandria, Va. "New investors are going to be cautious in the short term."

Mr. Bastian said the airline's

restructuring makes its long-term potential good.

In addition to slashing its debt to \$7.6 billion this year from about \$17 billion when it filed for bankruptcy protection in September 2005, Delta cut 6,000 jobs and wrested more than \$880 million a year in concessions from pilots, flight attendants and other employees. In addition, Delta executives bet big on the future of international travel by relocating many of the airline's wide-body aircraft to higher-margin destinations abroad from weaker domestic routes.

"You're seeing greater potential and greater growth in the international economy than you are in the U.S., and you're seeing Delta move from domestic further into international," Mr. Bastian said. Investors "buy potential and Delta has got great potential."

Still, it will take time to fulfill that potential. Despite its turnaround, Delta still trails competitors in terms of the revenue it squeezes per passenger per mile, lagging behind the industry average by 5%.

While it expects to close the

gap by the end of 2008, doing so will depend on the success of as-yet-unproven international routes. That is because a new destination, such as Tel Aviv, Kiev or Accra, Ghana, in its first year generates only about 80% of the revenue that it would when mature, Delta executives say.

Can't Control Everything

And as usual in the airline industry, the success of such routes depends on myriad factors that are well beyond the control of even the most focused and energized management teams—such as political instability overseas to a return of runaway oil prices. So while Delta may be leaner and meaner, it is still a company operating in a notoriously cyclical and volatile industry.

"If this is the top of an economic cycle, then Delta would be a richly priced stock," said Ray Neidl, an analyst at Calyon Securities in New York. "But if you assume we're only taking a breather and that the industry continues to do well, Delta is well-positioned."

TPG Stake Sale Could Be Prelude to an IPO

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amounts of money but not unlimited amounts of money," says Mario Giannini, head of **Hamilton Lane**, which invests in private equity on behalf of pension funds and endowments. It is indirectly one of the largest investors in TPG funds, but isn't involved in this deal. "There is a limited amount of money in the market" as private-equity firms target ever larger funds, he said, speaking generally.

In addition to selling a stake in the management company, TPG is considering a second move that could also open the fund to more public investors. TPG is considering packaging some of its existing fund investments in a new public company that could be bought and sold by stock market investors.

KKR's Struggle

In a slightly different move last year, **Kohlberg Kravis Roberts & Co.** raised \$5 billion for a publicly listed fund in Amsterdam, which essentially gives public investors a chance to invest in KKR deals alongside large institutional investors.

◆ **The News:** Corporate-buyout shop TPG, the former Texas Pacific Group, could sell 20% of itself to investors.

◆ **Background:** Other large private-equity firms have already been selling pieces of themselves during boom times.

◆ **What's Next:** A big IPO from a rival firm, Blackstone Group, was disclosed in March and could be issued in June.

The KKR company, **KKR Private Equity Investors**, hasn't traded well because it hasn't been fully invested, meaning it has had lots of cash earning low returns. By contrast, the possible TPG structure would bundle existing investments made by TPG and its limited partners investors in a new public company. Its existing investors would in exchange receive a slice of the stock in the newly listed company.

It is hard to structure deals like this because the value of underlying companies is often hard to discern. But proponents see the appeal: Listing it allows its limited partners to cash out when they choose to, rather

than having their money locked up.

Conditions are about as good as it gets for private equity. Stock markets are hitting records, which give private-equity investors a chance to raise new money and to cash out of their holdings. And debt markets are awash in cash, making it easy for buyout kings to raise money for deals financed by low-interest loans.

'Golden Age' or Bubble?

At a conference in New York 10 days ago, Henry Kravis, founding partner of KKR described current conditions as the industry's "golden age." And last week, David Rubenstein, co-founder of **Carlyle Group**, was telling audiences at the Milken Global Institute "it can't get better."

Such talk has given rise to speculation that these new capital-raising initiatives mark a peak for private equity, or at least a sign a bubble is in the making. In any case, the quest to free themselves from repeated rounds of fundraising would likely continue regardless of the cycle.

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Syndicated Loans: Past Week's Biggest Movers

Syndicated loans are corporate loans that are bought or traded by a group of banks and/or institutional

The Equity Roundup