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Hertz Global Holdings Inc. - L H S Restructuring

Bankruptcy Spotlight: White & Case powerhouse Tom Lauria takes us inside his grand slam home run result for Hertz stakeholders

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Hertz filed chapter 11 cases in Delaware in late May 2020 in full crisis mode, reeling from a severe liquidity crunch brought on by an unanticipated perfect storm of plunging revenues stemming from the effects of the Covid-19 pandemic and a sudden crash in used car prices, which materially increased Hertz's monthly rental costs associated with its 500,000-vehicle fleet. The company's ability to continue funding its operations and to pay its fleet-related costs was in jeopardy, and additional financing was unavailable.

The outlook for the Estero, Florida-based debtors' chapter 11 cases was, at that time, highly uncertain at best, with no guarantees as to the level of potential recoveries down the road for secured and unsecured creditors. Prepetition stockholders were in an even more precarious position. Hertz issued repeated warnings that the stock may end up valueless as a result of the chapter 11 filings and that its shares were at risk of being delisted from trading on the NYSE.

Against all odds, roughly one year later, led by attorney Tom Lauria, global head of White & Case's Financial Restructuring and Insolvency Practice; his team; and Hertz's other retained advisors, the company emerged from chapter 11 on June 30 pursuant to a plan of reorganization authored by Tom and his colleagues that slashed around $5 billion of the company's corporate debt (including the complete elimination of all corporate debt on Hertz's European business), provided Hertz with well over $2.2 billion of global liquidity and paid all secured and unsecured creditors in full, with the pièce de résistance being the delivery of more than $1 billion in value to prepetition stockholders – a result that seemed unthinkable a year ago.

The plan is being funded with over $7.5 billion in cash proceeds derived from direct common stock investments from a sponsor group led by Knighthead Capital Management, Certares Opportunities and Apollo Capital aggregating around $2.781 billion, the issuance of $1.5 billion from the purchase or other syndication of new preferred stock by Apollo (subject to a 2% discount or an upfront fee), a fully backstopped rights offering to Hertz's existing shareholders to purchase $1.635 billion of additional common stock and the funding of over $1.5 billion in new exit term loans.

Tom recently sat down with *LevFin Insights'* head of bankruptcy coverage and analysis, attorney Jason C. DiBattista, for a wide-ranging interview where he dissected the Hertz chapter 11 cases and how he and his team were able to achieve unquestionably one of the most spectacular results in the history of large restructurings, all against the backdrop of the Covid-19 pandemic and the unprecedented challenges that went along with it.

JCD: Tom, thanks for joining me today. When Hertz filed for chapter 11 in May 2020, the company was encountering a great deal of turbulence. The debtors made numerous statements that prepetition equity might ultimately be worthless and there were substantial questions whether creditors would be paid in full. A year later, all creditors are going to be paid in full and upwards of $1 billion in value is being returned to prepetition stockholders. How were you and your team able to achieve such a remarkable result? And please take us through the prefiling stages of the case.

TL: It was a big challenge and sometimes I look back and scratch my head thinking about how we were ultimately able to get it done. I will say this: The matter involved a lot of thoughtful moves on the chess board and a lot of really just old fashioned hard work, for starters.

The main drivers for the filing were, number one, the impact of the Covid-19 pandemic on Hertz's business and the resulting global economic shutdowns that reduced Hertz's revenue line to less than 10% of what it had been in 2019, on a current basis.

Simultaneously, there was a plunge in used car prices. That second piece was the straw that broke the camel's back because it resulted in a dramatic increase in the monthly rent that Hertz was obligated to pay under its vehicle-fleet-leasing program. That structure was set up so that Hertz could access asset-based securitization financing that is typically significantly cheaper than a regular financing and that creates flexibility to rotate thousands of vehicles in and out of the fleet on a regular basis and through mechanics that are less burdensome than might otherwise be the case, if you were doing a typical bank financing.

Those factors left the company in a terrible situation financially where the revenue was down because the vehicles weren't being rented and the rent for those vehicles was spiking up. It created an imminent threat to Hertz's liquidity and it became unclear whether we were going to have the wherewithal we needed to continue operating.

To preserve liquidity, we suspended making payment under the fleet lease and negotiated a brief forbearance with the company's lenders to give us time to try to find a solution. However, when we were unable to negotiate an extension of the forbearance, the company was left with no choice but to file for chapter 11 protection in late May 2020.

JCD: What were some of the early challenges the company faced after the filing, and how did you attack those issues?

TL: The big issue early on was to address the company's liquidity issues head on. First, we immediately took advantage of a provision of the Bankruptcy Code that allowed us to suspend rent payments for two months after filing. That breather gave us an opportunity to engage with the ABS lenders and we went to work in discussing with them what the path forward would be. We told them that our intention was to take advantage of a provision in the Bankruptcy Code that is called the "equities of the case" doctrine which allows the court, before the end of that two-month break in payments, to consider the equities of the case and to reset the rent, at least on a temporary basis, at a level that the debtors could maintain. So, we built a case to prove that that the rent should go down from, at the time, I think it was about $500 million per month to, I think, $85 or $90 million per month.

Ultimately, we were able to negotiate a six-month interim deal where our monthly rent payments for July through December would be on the order of just over a $100 million. And so, if you take into account the three months where we didn't pay rent at all, and then the massive reduction in rent over the next six months, we saved the company close to $3 billion, from a cash flow perspective, which really gave us the ability to extend our operating timeline and to focus on stabilizing the business.

As part of our deal with the ABS lender group, we agreed to reduce the U.S. fleet by 200,000 vehicles by the end of the year and use the proceeds to pay down the over $10 billion of ABS debt that was secured by the fleet. As we were cutting this deal, the market for used cars suddenly got hot and prices spiked up. This allowed the company to sell vehicles at high volume and at prices that were above book and even above market price, in many cases. By capitalizing on this opportunity, we were able to pay down the ABS debt far more rapidly than expected —we got the balance down to under $5 billion by the end of the year.

A little later, we negotiated and secured approval of a new $4 billion ABS facility with an affiliate of Apollo Capital to fund the debt needed to purchase new vehicles during the case, which was essential to maintaining a fleet that would be competitive whenever the business came back. We then paired that financing with a $1.65 billion DIP financing facility, which was also led by Apollo, to fund ongoing operations and the equity contributions the company would have to make to fund new vehicle purchases.

So by only about four or five months into the case, we had completed over $6 billion of financings, which I think was quite remarkable given the circumstances and the state of the business and the overall economy at that time. That set us up for the next steps.

JCD: I wanted to touch on an interesting series of events that occurred in June 2020 when Hertz sought court authority to issue up to around 247 million shares of common stock, despite numerous public warnings by Hertz that the stock might ultimately be worthless. Despite receiving court authority to do the sale, the SEC ultimately shut the idea down. What happened there?

TL: Well, look, it was a crazy moment in time and as I said, we were very concerned with liquidity. We anticipated that we would have to at some point raise DIP financing and DIP financing is expensive, as you know. So, shortly after we filed, Carl Icahn, the company's largest prepetition shareholder at one time, sold all of his stock at a very low price. I think he finally concluded that the prospect of a turnaround was so remote that it wasn't worth his time. So he sold out and these day traders became very active, making Hertz maybe the first "meme" stock. All of a sudden, we see our stock trading at about five bucks a share. And because we had done an equity offering in 2019, we had an active shelf registration with the SEC to be able to issue up to 250 million shares. You do the simple math, Jason. 250 million shares at five bucks a share is $1 billion and a quarter. Even at four bucks a share, it's a billion. At three bucks a share it's $750 million.

So the thinking was, if people want to buy shares at the market price, why shouldn't the company be able to participate in those transactions and make some money? And we also thought that raising money that we need to run the business to stay alive as equity, was way better for the shareholders and our other stakeholders than raising money as debt, because debt has to get paid ahead of stockholders in a chapter 11. We also had discussions with some of our key stakeholder groups and nobody objected.

We filed our motion. We updated our disclosures. I think no less than seven places in the disclosure materials did we say that the shares may be worthless. We weren't trying to fool anybody, but there seemed to be an appetite in the market to take risk. And, the reality is whenever you buy equity, whenever you buy debt, whenever you buy any security, you're taking risks. To get the upside, to get multiples on your investment, you take the risk that you can lose your investment. So, it's really not right to say that you shouldn't be able to sell equity of a bankrupt company. I think you have to—so long as the disclosure is good—let the market speak, which is what we decided we would do. At the hearing, the SEC appeared and did not object. The judge then very enthusiastically approved the motion, which was on a Friday.

So that's what we did. We started selling shares at the market on Monday and to our dismay, the SEC reversed course in the afternoon and said, "Hey, we're really concerned. We've got to look into this. We're concerned about the disclosure. We've got a problem with what you're doing."

You know, you don't mess around with the SEC. When they send signals like that, you have to hear them. And so we shut it down. Right afterwards, Jay Clayton, who was then the chairman of the SEC, live on TV, without any advanced warning, really ripped this whole idea that a bankrupt company would be selling shares. And became apparent to us very quickly that this was a dead idea that we were not going to be able to proceed with it.

The irony of all this is, Jay Clayton is, today, the chairman of the board of Apollo who has, through the course of the Hertz case, from beginning to end invested about $8 billion in Hertz between providing the $1.65 billion DIP financing in part, the $4 billion ABS financing, buying the Donlen fleet assets for around $1 billion and providing $1.5 billion of preferred equity to sponsor the company's plan.

JCD: After stabilizing the company's liquidity position in the ways you talked about, please tell us how the company began formulating a chapter 11 exit strategy and what happened next.

TL: Well we needed to reduce the amount of debt that we would have to pay off under a plan of reorganization. We were looking at a roughly $7 billion hurdle to clear between the first- and second-lien debt, the unsecured notes, the DIP borrowings and other amounts.

We had a first board meeting, I think, right before Halloween 2020, where we walked the board through the process of exiting from chapter 11. We said that it would be desirable to be able to get out of bankruptcy by the end of the second quarter of 2021, for a number of reasons. Obviously bankruptcy is expensive. Number two, it was going to be impossible to get long-term financing for the fleet while in bankruptcy. Number three, historically the third quarter is the most important quarter for Hertz business. So we planted our flag and targeted June 30, 2021, as the targeted exit date, even though we thought it was probably unrealistic to be able to get out by then. But if we didn't set that target, we felt we might not end up getting out in 2021 at all, which we knew would really be disastrous for the long-term prospects of the business.

We explained our strategy and proposed timeline to our key stakeholder groups in early November and commenced the diligence process before Thanksgiving, with the goal of getting the framework of a deal in place by early February. We created a data room. We started engaging with a bondholder group, which we thought was a likely a plan sponsor. They looked to us like the fulcrum security, which turned out to be wrong. We also engaged with a few other groups that quickly boiled down to two: one comprised of Centerbridge Partners, Warburg Pincus and Dundon Capital Partners; and the other led by Knighthead Capital Management and Certares Opportunities, which, at the end of the process would also include Apollo.

We got expressions of interest from all three towards the end of January, all of which were really disappointing. They were all suggesting that a transaction would get done at an enterprise value of between $3.3 and $3.6 billion, which would have given the bonds a roughly 15-20 cent recovery and leave nothing to equity. It was nothing close to what we wanted.

JCD: Is there anything in particular you did then to get those parties to increase their proposals or did it happen organically?

TL: Actually, yes we did. Rather than taking the typical route of going back to the bidders and asking them to improve or enhance their proposals, what we did was develop a straw man proposal that laid out the terms for a plan of reorganization and related financing that would be acceptable to Hertz. The highlights of that proposal included that we didn't want to have more than around $1 billion to $1.5 billion of funded debt on the company at exit, we wanted to have about $2 billion of overall liquidity in the business to give us sufficient cushion to operate the business going forward, and we wanted to get a 70 cent payout to our unsecured creditors. To achieve that, the transaction would have to be at roughly a $4.5 billion valuation.

I remember presenting that to the board of directors in early February, and people thought I was out of my mind, that there was no chance, given where the expressions of interest were, that we would get any nibbles at that level. But at the same time, nobody could come up with an alternative path forward or a reason not to throw that line out and see what happened.

And to our surprise, in less than a week, the Certares/Knighthead group came back with a markup of our proposal that included minimal changes and actually increased the transaction value from $4.5 to around $4.8 billion and supported a cash payout of 70 cents for unsecured creditors, payment in full of DIP facility claims and first- and second-lien claims, along with an investment opportunity being provided to unsecured creditors who wanted to participate in the equity as opposed to taking the cash out.

JCD: Why do you think the bids came so far so fast?

TL: Well, I think two things. First, I represent distressed investors and strategic investors all the time and there is one thing I know – everybody wants to buy these companies and assets at the cheapest price. So I can't blame them for all kind of throwing out a low-ball bid initially to test the waters; to see if they can maybe get the company at a bargain price.

So the question for us was how we would get the price up? We noticed that our bonds were trading up. By now, they had gotten to about 50 cents on the dollar, up from 15-20 cents when the case was commenced. We took that as a signal that there was some significant interest in the company. We also kept looking over our shoulder at what was happening with the price of Avis stock. It was trading up to pre-Covid prices, which was starting to suggest that Hertz could be viewed as an $8 billion company, maybe more if we could solve our problems.

So I think the bidders all had dry powder, but I think what Certares/Knighthead seized on was an opportunity to get in the pole position and be embraced as the plan sponsor quickly.

That is exactly what happened, and we filed the Certares/Knighthead initial plan on March 2.

JCD: That seemed like the moment when things really started to cook for the debtors, with price just going up and up at that point, would you agree?

TL: I sure would. The frothiness of the market was increasing in March. Our bond prices started trading up above 70 cents to around 75 cents. They got up to like 75. As a result, we renewed conversations with the Centerbridge group, which decided to engage with the bondholders and see if they could join forces to make a competing proposal.

Ultimately, the Centerbridge/Dundon/Warburg group got together with the bondholder group and put together a fully funded proposal that we determined was our best path out of chapter 11. So, on April 3 we terminated the Knighthead/Certares deal, signed up with the Centerbridge group and filed an amended plan under which the bondholders would get around 48% of the new equity of the company or a 75% cash payout, plus the right to purchase additional common equity at plan value, but still no recovery to current equity at that point. We were prepared to march into court later that month to seek approval of our disclosure statement in connection with that amended plan.

On a parallel track, we were working hard to get the debt financing in place for whatever plan we ultimately settled on, including around $3 billion between a revolver and a term loan and about $7 billion of new ABS facility commitments. We used the April 16 disclosure statement hearing as a deadline to get the financing committed. We were driving everyone really hard; I think they thought we would ultimately agree to push the deadline to give them more time. But we didn't. We sensed there was a building momentum and didn't want to lose it. So, to I think everyone's surprise, we got the financing fully committed on the 15th so we could walk into court on the 15th with a fully funded deal. We had a lot of balls in the air.

JCD: From a sponsor competition standpoint, things just kept heating up even further at that point, right?

TL: That's right. We knew Knighthead and Certares still wanted the deal but were struggling with funding. Since the bondholders signed up to equitize their debt under the Centerbridge deal, for the Knighthead/Certares group to compete, they needed to be able to raise enough cash to pay the bonds in full. That was a tall order. So, right before we signed up with Centerbridge, we put Knighthead in touch with Apollo, who was looking to write a big preferred equity check.

As we moved forward to the April 16 hearing, we kept hearing rumors that Knighthead/Certares were still working on something; we knew that they weren't ready to throw in the towel. We anticipated getting an improved offer from them at the eleventh hour. Sure enough, we got a letter from them on the 15th on the eve of the disclosure statement hearing, maybe eight o'clock at night, saying that they were going to give us a new proposal. Then, at about one o'clock in the morning, I got an email attaching a revised plan from Knighthead, Certares, Apollo and an ad hoc shareholder group, that included more than $4 billion in common equity commitments, another $2 billion of preferred from Apollo, and would not only pay unsecured creditors in full, but would also provide 50 cents per share to our shareholders.

At the hearing that morning, the court told us to take a few days and further analyze the competing proposals and come back to court the following week with a decision on a final path for the cases.

So we worked with the board and the two bidder groups over the weekend. At the end of that process, we decided to go with the Centerbridge proposal, which had been sweetened to provide warrants to shareholders that we valued at about 90 cents a share.

We got the disclosure statement approved on the 22nd and set a June 10 confirmation hearing, but we knew that Knighthead/Certares/Apollo still had an appetite to compete, and by setting the confirmation hearing and then setting bidding procedures for additional proposals, we did what we could to keep their feet to the fire to improve their last offer.

JCD: Take us down the homestretch of the competitive process and all the way through exit on June 30.

TL: Well, at that point we knew we needed to keep pushing so that is what we did. We got rather unique bidding procedures approved and set a quick sale timeline designed to keep moving the ball.

Sure enough, on around May 5, Knighthead/Certares/Apollo came up with an even better plan that provided for payment in full of all secured and unsecured funded debt, with an improved recovery to prepetition equity holders of 50 cents per share in cash plus either 10-year warrants for an aggregate of 10% of new common stock or, for eligible stockholders, certain rights offering subscription rights. It was a very strong proposal.

The board met and we decided that plan was the current highest and best. That gave Centerbridge a couple of days to decide whether they wanted to top – which they decided to do, leading to the auction in Miami that began on May 10 around 10 a.m. It went on for over 30 hours straight with plenty of tension-filled moments.

In the end, we picked a further improved plan from Knighthead/Certares/Apollo that was going to be funded through around $2.8 billion in direct common stock investments from the Knighthead group and other investors, the issuance of $1.5 billion of new preferred stock to Apollo, and a fully backstopped rights offering to existing shareholders to purchase $1.635 billion of additional common stock, with payment in cash in full of all administrative, priority, secured, and unsecured claims and a further improved equity recovery to existing stockholders that will pay that group more than $1 billion in value, which made everybody happy. It was an incredible outcome.

We then had a hearing on May 14 to seek approval of the new plan sponsor and Judge Walrath was grinning from ear to ear at the result. She was very happy to approve it.

We were then able to get the plan confirmed in June, get all our financing done, and get out of chapter 11 on the exact timeline we were initially shooting for last year.

It was all just unbelievable.

JCD: Thanks so much, Tom.

TL: Appreciate it very much.

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