Quickie idea: GTX bankruptcy $GTXMQ

This post is another in a series I do on an irregular basis. A "quickie" idea is an investment specific idea that I've been mulling over and find interesting, but haven't dove fully into yet. The hope is to provide the jumping off point for a discussion of an idea I find extremely interesting right now, as I suspect the opportunity could be fleeting.

Before I get to this particular idea, a disclaimer: this company is in bankruptcy, and I am long it. Obviously, investing in an equity in bankruptcy involves huge risk. Nothing on here is investment advice or a recommendation (with the exception of the idea that a SPAC should partner with Kimball Musk; that's a recommendation that needs to happen). I am not a lawyer, and investing in bankruptcy involves a whole host of risks.

Ok, that out the way, let's get to the idea: buying GTX stock (ticker: GTXMQ; disclosure: long) in bankruptcy on the potential for a large equity distribution.

Again, this is a quick idea, so I'm not going to go into full detail. But the basic overview is that GTX was spun out of Honeywell a few years ago. As part of the spin, Honeywell saddled GTX with the obligation to reimburse Honeywell for some legacy asbestos liabilities. Fast forward a few years, and GTX filed for bankruptcy to, in effect, zero out those legacy liabilities (there were other reasons, including trying to recoup some payments they already made to Homeywell, but zero'ing these out was a big reason).

GTX filed for bankruptcy with a stalking horse bid from KPS to buy most of their assets for $2.1B. KPS has subsequently raised their offer to $2.6B (though they also added some assets that they weren't previously buying to the bid), while a group of equity holders lead by Centerbridge and Oaktree have partnered with Honeywell to make a counterproposal that will see the equity reinstated while injecting $1.1B of preferred stock into the company to fix the balance sheet.

At this point, I think the story can play out in two paths: either the company can pursue the KPS deal and auction their assets with KPS serving as the stalking horse (the KPS path), or the company can take the Centerbridge deal and take a big preferred equity injection (Centerbridge path). Let's explore those two paths and I think you'll see why I think this is interesting.

The KPS path probably holds the most upside. I'd encourage you to go read docket 15 from the case (you can find GTX's case here); this docket is the CFO's statement on the bankruptcy (may be worth noting the CFO was hired over the summer). The whole thing is super interesting, but again this is a quick idea so I'm not going to cover everything. Paragraph 84 is what matters here,

> *The Debtors currently anticipate that, if the Stalking Horse Purchase can be consummated on the terms contemplated by the Stalking Horse Purchase Agreement, the Liquidating Trust will be in a position to make a distribution to stockholders after the consummation of the sale, subject to the Proceeds Allocation Settlement (defined below) and resolution of*

claims.

At the time, KPS was bidding just $2.1B for Garrett's assets. KPS has since raised their stalking horse bid to $2.6B, a $500m increase. We know that they thought the initial deal would result in an equity distribution; any increase in bid should fall straight through to an increased equity distribution.

GTX has ~76m shares outstanding. If the full $500m increase in KPS's bid falls straight through to equity, them means KPS's new bid should result in an additional ~$6.58/share in distribution to GTX stockholders ($500m / 76m shares outstanding) on top of whatever the initial distribution planned from KPS was.

GTX is currently trading at ~$3/share. If I'm reading that situation correctly, if the KPS stockhorse bid goes through, GTX is going to be getting a distribution that's literally mutliples of today's price.

And note that, if the sale/auction track is pursued, the KPS deal might actually get beaten. Remember, KPS's bid is a stalking horse bid; a stalking horse bid is designed to set a floor valuation for a bankrupt companies while other bidders come in and do work on the company. It's entirely possible that, if we pursue the KPS track, a few other financial sponsors or strategic come in and bid on GTX, and the final sale price is even higher!

There is, however, a huge "but" here. The whole premise of the

GTX bankruptcy was to get out of the Honeywell liabilities. The CFO describes the background of these and why they don't think the liabilities are valid in much greater detail in docket 15, so I won't rehash that here, but the basics of the revised KPS bid (and the original KPS bid!) are that the Honeywell liabilities can be stranded / excluded. If the Honeywell liabiltiies need to be paid, then they would likely consume the entire estate and shareholders would be unlikely to see a distribution from the current KPS bid (though there is a scenario where a sale/auction path is followed and the bids get so large that the Honeywell liabilities can be paid in full and shareholders still get a distribution.).

Which brings us to the other path. Centerbridge has partnered with Oaktree, Honeywell, and a growing list of other shareholders to offer a counterproposal. To simplify, the proposal is that the shareholders inject $1.1B of convertible preferred into GTX. That cash is then used to pay, in full, every creditor except for Honeywell (the proposal includes the quotes "all unsecured creditors receive payment in full" and "Honeywell will be the lone impaired creditor"); Honeywell will convert their liabilities to a preferred stock whose mechanics I will ignore for now. Current shareholders will simply continue to own their equity.

There are significant upsides to Centerbridge's plan from a bankruptcy perspective. Centerbridge, Oaktree, and their group are approaching 50% ownership of GTX (if they haven't gotten there already). If you thought about this in a vaccum, having a bankruptcy plan presented to you that said "hey, every creditor except one gets paid in full. The one impaired creditor is agreeing to this plan. And more than 50% of shareholders have agreed to this plan"..... well, that seems like a pretty tidy bankruptcy clean up there!

However, there is an issue with that plan: minority shareholders not in the Centerbridge group appear to be getting less than the Centerbridge group. Yes, minority shareholders are reinstated, but Centerbridge has injected a mammoth chunk of preferred equity in front of them at what I would say are very attractive terms.

Basically, the Centerbridge equity group is getting a better deal than other equity holders (GTX's response goes into this a little more). Centerbridge will point to the Peabody / Elliot case as precedent for a court allowing one group in a call to be favored over the rest of the class.

There was a call on Weds (October 21) to discuss the bidding procedures for the KPS deal and the two competing paths (debtwire had a summary of that call); that hearing will continue this afternoon (per docket 263). I'm not a lawyer, but it seems possible that we know after this hearing which path we're going to go down. However, just reading the air in the room, it seems like the judge is going to try to keep the optionality to pursue all options and let the groups keep fighting it out before forcefully choosing one path or the other if the groups can't agree to anything (again, not a lawyer, so I could be off on timing and path or basically everything here, but that feels right to me).

So the two choices appear to be: choose the KPS path and stockholders will get significantly in excess of today's share price if zero'ing out the Honeywell liabilities is allowed, or chose the Centerbridge path and quickly emerge from bankruptcy with shareholders intact but pretty low in the capital structure as they're behind a ton of new prefs and the reinstated Honeywell liabilities (now converted to prefs).

Obviously, as a shareholder, you'd prefer the first path though the second path doesn't appear to be an immediate zero. I think each side has a compelling case.

However, I do think there's a tell here. Honeywell joined Centerbridge's group and agreed to be the lone impaired creditor. To me, that screams that Honeywell knows they're playing a weak hand and that there's a good chance their claims get stranded / zeroed. By partnering, Honeywell and Centerbridge hope that they can create hundreds of millions of value for themselves by offering a quick restructuring that is consensual across the board (Honeywell creates value for themselves because they get tons of value of their claims; Centerbridge creates value for themselves by injecting money at really favorable terms). The losers here are the minority shareholders who would have made way more in a contentious process that lead to Honeywell's claims getting zero'd (and, again, by agreeing to be the lone impaired creditor, I think Honeywell has shown that they think there's a real chance of getting zero'd).

So I think GTX is a really intriguing bet here. If the KPS deal goes through, I suspect Honeywell will get zero'd out and shareholders will take in a huge liquidation payment (with upside if a bidding war happens). And I believe it's more likely than not that some form of the KPS deal is what goes through.

Four more notes before signing off:

1. Again, this is a bankrupt stock and the risks are high. Do your own work / nothing here is investing advice. And I'll call out again there's the hearing on bidding

procedures continues today (October 23) at 3 PM EST; if that results in clarity in going down either path, there's a chance this article is hopelessly dated in less than 8 hours!

    - Your largest risk is probably tonight. The worst case scenario is KPS is rejected as stalking horse, and then the Centerbridge deal falls through for some reason and the company is left in the lurch. I don't think that's likely for a host of reasons, but that's probably you're biggest immediate term risk.

2. Remember that if you go the KPS route, there's a chance of a bidding war. And I think the chances are decent! I'm not familiar with KPS, but I've talked to two people who are and both of them said KPS is known as a shop that pays a very low multiple for assets; having KPS as the stalking horse could be something of a signal to other sponsors to sharpen their pencils and put in a topping bid. And the interest from Centerbridge seems to confirm that there's significant equity upside around the valuations we're discussing. When you get this many sharp buyers trying to cut their way into a deal, it's normally a signal that there's something attractive about the company
    - There's a few different angles to "something attractive about the company," but I think the most important one is just the valuation. Adjusted EBITDA before Honeywell payments was ~$600m and annual capex was around $100m, so you're talking about a pretty attractive multiple in the KPS bid.
    - KPS's updated bid allows for equity to participate into 24% of the new company; I've ascribed that no value and there are some interesting hooks to that offer. I do think there's value from that deal and I think the hooks are there for a reason, but we'll see....
3. If you read the transcript of the hearing from

Wednesday, two lines stand out that are curious to me

- "Under the KPS deal, shareholders would receive something like $700m in distributable value, including proceeds of the resolution of the Honeywell dispute." That's a giant number for the equity, but the wording is strange, as the revised KPS deal gives the settlement of the Honeywell dispute to KPS (if I am reading it correctly).
- The Centerbridge lawyers says "our standalone plan has a value of USD $3B." I'm not sure how they're coming up with that number (though it would be positive for overbid potential if they go the KPS route!).

4. The situation is dramatically more complicated than I've laid out here. There are all sorts of angles and complications I didn't discuss. Again, this is just a quickie idea! So, do your own work, and if you have done your own work, please feel free to reach out to discuss further!
    - PS I tweeted out about GTX, and there are some very thoughtful comments and questions in the thread if you take a look.