

DETROIT DO-OVER

GM's JOURNEY FROM INSOLVENCY
DENIAL TO A CHAPTER 11 FILING



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Preface

GM

What drove General Motors into bankruptcy? It's tempting to blame the broader financial crisis, which torpedoed the US economy, slashed car sales and shut carmakers out of the capital markets. That certainly precipitated the demise of America's largest carmaker. But it was not the ultimate cause.

Insolvency has, in fact, been stalking GM for several years. And as this collection of articles by our correspondents shows, Breakingviews.com caught on early - and not just because GM's manufacturing business was posting an operating loss year after year.

In April 2005, for example, while markets were worrying about rating agencies downgrading the manufacturer's debt a notch or two, we first calculated that GM's onerous unfunded healthcare and pension liabilities had punched a multi-billion-dollar hole in its balance sheet – and that filing for chapter 11 bankruptcy protection looked like the only way to get GM back on track.

That's not to say GM's executives sat back and did nothing. In the past four years they have halved the shop floor workforce in the US, laid off white collar staff in droves, renegotiated union contracts and healthcare costs and sold businesses like Allison Transmission and GMAC, its financial services arm, to raise cash.

The problem was, none of that was enough. The company was losing market share faster than it could shrink its operations, even before the precipitous declines of the more recent credit crunch. And other measures were either slow to materialise, such as slashing the dividend. Or they were shunned as taboo by then chief executive Rick Wagoner, such as shuttering or

selling some of GM's eight brands, whose products often competed for consumers' attention.

Even this year, while on US government-funded life support and under imminent threat of bankruptcy, GM executives appeared to move too slowly. They twice had to revise their rosy assumptions for their restructuring plan and could only watch as Ford - which has received no aid from Washington - was quicker to strike deals with the unions and its creditors.

Though we have argued strongly in favour of GM seeking bankruptcy protection, we take no pleasure in being proved right. With luck – and with the generous support of US taxpayers whose \$60bn or more of loans, as we argue in the final piece in this collection, are unlikely to be repaid in full – the expedited bankruptcy process the Obama administration is steering GM into will allow the company to emerge in a position to compete profitably again. If not, another bankruptcy will be on the cards.

Antony Currie and Rob Cox
Breakingviews.com

June 2009

Chapter 1 – The case for bankruptcy

Should GM reboot through bankruptcy?

By Edward Hadas and Marianne Brun-Rovet

As General Motors boss Rick Wagoner takes charge of the company's US factories, he should ask himself a basic question: Why bother? There's no question GM needs a tune up. And Wagoner may be the mechanic for the job. But GM faces a bigger problem, one that a few fiddles in the engine room are unlikely to fix – long-term solvency.

The threat to solvency comes from the company's huge future liabilities for pensions and healthcare. The big number is the \$61bn of unfunded healthcare liabilities, of which \$28bn are on the balance sheet. These are likely to get substantially greater as the ratio of retired to active workers – already an astonishing 2.4 times – increases. As for pensions, the company reports a mere \$8bn underfunding at the end of 2004, but more realistic return assumptions would bring the total up.

Those off-balance sheet liabilities are not exactly debt, but they already dwarf the company's \$28bn of equity. As the workforce ages and these obligations have to be paid out, GM will struggle to find the cash.

To solve these problems for good, GM needs to reboot. Declaring bankruptcy would do the trick. US airlines do it with startling regularity, allowing them to redraft the terms of their benefits for employees and retired workers, occasionally with the help of the government.

But hold on. Is GM really like the airlines? In two important respects, it is. First, GM has the same sort of unaffordable retirement burden. GM's extra pension and health care costs

give it a \$1500 starting cost disadvantage against Japanese carmakers for each vehicle it produces.

Second, like the airlines, GM can blame the structure of the US retirement and health care system. For years, the pension system encouraged good employers like airlines and carmakers to take on open-ended liabilities for their workers. That made the politically powerful unions happy and reduced the pressure on the government's own retirement programmes. But the regulations also encouraged companies to underestimate the amount of money that should be set aside to take care of these promises. For mature companies, these liabilities have proved crippling.

Still, bankruptcy might sound extreme. After all, GM reported earnings of \$2.8bn in 2004. And it has \$20bn of cash in the kitty. On the face of it, GM hardly looks like it is at death's door.

But those earnings come entirely from the finance business, General Motors Acceptance Corp. GMAC earned \$4.3bn before taxes last year while the vehicle operations lost \$3.1bn. GM now reckons its automotive operations will burn through \$2bn this year alone.

As long as GMAC continues to make money, the industrial business could limp along for years. Wagoner has been brought in to help stop the burn. But even a super-manager could not expect to overcome the huge cost disadvantage caused by its healthcare liabilities, cut-throat competition in the US market and overcapacity in the global automotive industry.

So GM is likely to remain entirely reliant on GMAC. But GM's money-losing ways are a threat to the finance business. GMAC depends on the parent company's credit rating to fund itself in the capital markets. As the group's woes have grown recently, GMAC's unsecured bond spreads have widened. Bankers are trying to find ways to ring-fence GMAC from its parent's woes,

but it will not be easy as long as GM controls GMAC's cash flow.

GM should act now to preserve both companies. One solution would be to sell GMAC. Putting GMAC's net profit of \$2.9bn on a conservative multiple of 11 values the finance arm at \$32bn. But the proceeds would simply fund future healthcare liabilities. That would do nothing for shareholders while only partly solving GM's solvency problem. It would still need to find another \$30bn to cover all of its deficits.

A better option would be to break GM into two – a finance business and a carmaker. This would not be simple, since a large proportion of GMAC's business comes from GM. But necessity is the mother of invention. After all, GM managed to spin off Delphi, its captive auto parts business, in 1999.

Bereft of the cash drip-feed from GMAC, the car business would have to face up to the realities of its long-term liabilities. Bankruptcy looks like a realistic option. It would be the reboot the company needs to restructure its pension and healthcare obligations. And it could bring its costs down to the level of its increasingly agile Asian rivals.

A split-up followed by bankruptcy would not be an easy option. Lawyers, politicians and unions would have to be pacified. But it is the only realistic way to keep GM going.

April 13 2005

The irony of history

By Edward Hadas

"What's good for the United States is good for General Motors." That was probably true in 1953, when Charles Wilson, then head of the world's largest carmaker, made the comment. It's time to change the motto to: "What's bad about GM is bad about much of US industry."

Of course, most US manufacturers aren't as far gone as GM. But the pattern is similar. The US has lost global market share in almost every category of tradable goods, not just cars. It now imports 50% more than it exports. The common themes are underinvestment, and excessive health care and pension costs.

GM has been kept afloat by the profits of GMAC, the finance subsidiary it has now said it may sell. But GMAC's success isn't that comforting for the US. It is part of the apparatus that has let consumers gorge themselves on gas-guzzlers and the like with cheap credit. Debt-hungry US consumers are keeping the economy moving. The problem is that this binge is being financed from abroad. And when foreigners get tired of paying for the American lifestyle, the US may not have enough GMAC-style assets to sell.

October 21 2005

Death by a thousand cuts

By Edward Hadas

General Motors is suffering a death by a thousand cuts under Rick Wagoner's so-called recovery program. It would be far better if it bit the bullet, filed for bankruptcy and got itself a new boss. That would give what is still the world's largest carmaker the best chance of a rebirth.

This may seem an extreme solution. After all, GM says its book value was \$22bn at the end of September. But that's based on optimistic accounting assumptions, some of which are being investigated by the Securities and Exchange Commission.

Most important is how GM treats its pension promises. By assuming it can earn 9% a year on its pension plan, it manages to report an astonishing \$1.5bn surplus. Using more conservative assumptions, the Pension Benefit Guaranty Corporation says there's a \$31bn deficit. Then there are the pension and healthcare promises GM made to Delphi, a former subsidiary which recently filed for Chapter 11. There's no resolution on what GM might have to pay, but the carmaker itself says it could be up to \$12bn. Include these and it is easy to see how GM's adjusted book value could be negative.

GM could, of course, try to negotiate down GM's pension liabilities without filing for bankruptcy. It could also continue to chip away at health care and other costs. But it costs GM some \$2,000 more than it costs its Japanese rivals to produce an average vehicle. That's why its car operations are losing \$2bn each quarter.

Wagoner's salami-slicing of benefits won't solve the problem; it will just delay the inevitable. By contrast, Chapter 11 would focus everyone – workers, pensioners, lenders, shareholders and the government – on the need to make sacrifices.

As for Wagoner himself, his efforts to grow GM out of its problem haven't worked. Investments in foreign car producers like Italy's Fiat and Japan's Fuji have been expensive mistakes. Meanwhile, with fuel prices now so high, the company is suffering from Wagoner's excessive emphasis on fuel-guzzling sports utility vehicles. He is too identified with the company's decline to be a credible part of its recovery. GM needs a radical plan and a new leader to take it forward.

November 11 2005

Fearful addition

By Edward Hadas

Kirk Kerkorian believes a dividend cut will nurse General Motors back to health. The billionaire investor, who owns 8% of the car company, is underestimating the scale of the problem. The hole in its balance sheet may be around \$47bn – enough to wipe out all the shareholders' equity, savage its already badly impaired debt and squeeze even further workers' pensions and health benefits.

Start with GM's assets. The vehicle business is losing money – \$6bn in the first nine months of 2005. But the world's biggest car maker is worth something, providing the bleeding can be staunched. Assume it could eventually get operating margins up to 3%. After tax and applying a multiple of 10, the business would be worth \$32bn.

Then there is GMAC, the company's finance business, in which GM is trying to sell a majority stake. It doesn't look like buyers are lining up. Investors are talking about something like a multiple of 1.1 times book value, or \$25bn.

Finally, there's GM's cash pile. That was \$14bn at the end of the third quarter. But operating losses and restructuring

expenses could consume about \$8bn of that by the end of this year, leaving only \$6bn. Tot it all up and there are perhaps \$63bn of assets.

That sounds nice – until one looks at GM's liabilities. If all it had was \$32bn of debt, it might be OK. But it has three other liabilities: pensions, health care and obligations to workers at Delphi, a bankrupt former subsidiary.

GM has just reported a \$6bn surplus in US plans. Netting that off against the \$9bn deficit in its foreign plans might suggest an overall deficit of \$3bn. But that's too optimistic. The US Pension Benefit Guarantee Corporation, a government agency, estimates it would cost \$31bn to wind up the US pension plans. That may be pessimistic. But even taking half that figure would boost the global deficit to \$18.5bn.

Similarly, GM itself admits to only \$27bn in unfunded health care liabilities. But, again, GM is too optimistic. It is expecting that health care inflation, currently 10%, will drop to 5% by 2010. Use a more realistic figure like 8% and GM would be left with a total obligation of \$47bn, even after giving it some credit for its latest cost-crunching deal with its union.

Then there's the company's liability to Delphi workers, which GM says could be as high as \$12bn.

Add it all up and the liabilities come to \$110bn – \$47bn more than the assets.

How to fill the hole? Unless the value of the assets can be miraculously boosted, the liabilities are going to have to be cut – in bankruptcy. Shareholders would be wiped out totally. Meanwhile, bondholders and workers, who rank equally, would be savaged. To make the above numbers balance, they would each have to take a 43% haircut.

That's more than 30% hit the bond market is currently counting on. It would also be hard to persuade workers to accept benefit cuts of this scale. Politicians may well be tempted to intervene. After all, counting GM's retirees and dependents, a million votes are at stake.

Robert Lutz, GM's vice chairman, said this week that talk of bankruptcy is "a crock". And in Washington, talk of direct aid is still taboo. But the numbers tell a different story.

January 13 2006

Chapter 2 – Stuck in a low gear

Lezione Italiana

By Rob Cox

Two years ago, Fiat was the wreck of the car industry. Its absorption into General Motors looked preordained. How things have changed. Today Fiat's market cap is nearly \$15bn – a fifth greater than GM's. Apart from savouring this stunning reversal of fortunes, is there a lesson the Italians might provide GM and its investors?

The Detroit carmaker's current travails certainly mirror those from Fiat's darkest hours. Car sales have plummeted, market share is sliding, factories and workers are idling and the business is devouring cash. The stock has skidded, the dividend slashed and debt rated junk.

Fiat surmounted these obstacles by jettisoning assets not central to its industrial focus on cars, trucks and heavy machinery. But it also cut closer to the bone, not only selling most of its financing arm but a chunk of its crown jewel, Ferrari. It swapped debt for equity, sold new shares and wangled \$2bn from GM for giving up the right to force it to buy Fiat Auto. That allowed Fiat to re-invest in its area of expertise, cheap and cheerful cars. Last year, Fiat snapped a 17-quarter run of losses and the stock has surged 80%.

GM's playbook is not too far off from Fiat's. One notable distinction is the slower pace at which GM's board appears to be moving. It halved the dividend instead of dropping it, for example. And management appears unwilling to part with ancillary marks, such as Hummer and Saab, something its new, hard-nosed director Jerry York called for.

But there are two other critical differences. Fiat had nothing like GM's long-term healthcare and pension liabilities. These may be insurmountable without a bankruptcy filing. Oh, and Fiat's board did something else that GM hasn't – it fired four chief executives before it found the right turnaround artist in Sergio Marchionne. If GM studies Fiat's lesson closely, that can't be far behind

March 24 2006

Counting chickens

By Antony Currie

General Motors chief Rick Wagoner heads into the carmaker's annual shareholders' meeting on Tuesday in much better spirits than he started the year. It's not hard to see why. GM's stock is up almost 40% this year. Wagoner has enjoyed a few successes recently, such as selling a majority stake in finance unit GMAC. But he's done less to address the fundamental problems the beleaguered car manufacturer still faces.

GM doesn't have the best mix of either buyers or vehicles. About 40% of its vehicles are sold to fleets and employees. That's higher than its rivals, and is less profitable than selling to the masses. And GM relies heavily on SUVs, whose sales have been hit by rising petrol prices. GM's models are twice as sensitive to these increases in energy costs as competitors', according to Citigroup.

To be fair, GM's continuing loss of market share – sales were down 16% in May – forced Wagoner to cut costs. In March he offered his 113,000 US workers a four-tier voluntary redundancy package based on length of service. More than 20,000, Wagoner's target, have accepted, according to reports.

That's encouraging. But not if those taking redundancy are workers near retirement age. They'll keep the generous pension and healthcare benefits that GM needs to restructure if it is to avoid bankruptcy. And the redundancies might not be enough to keep up with GM's falling market share. Many analysts expect GM's US share to drop from just under 25% now to below 20% in the next few years.

Then there's GM's cash situation. It burned through \$1.2bn in the first quarter, despite booking a small accounting profit, offering few sales incentives and using just \$1.3bn of this year's \$8.7bn capital spending budget. With oil prices rising, incentives creeping back, and car sales falling, earlier estimates that GM would burn \$4bn in 2006 look conservative.

That leaves GM still on shaky ground. Sure, with its sale of 51% of GMAC, and other divestments, GM will add about \$11bn in cash to its pile. But for as long as the carmaker continues to burn through it, that extra cash is simply delaying bankruptcy, not avoiding it.

June 6 2006

Recovery Road

By Antony Currie

More good news from General Motors: 35,000 workers have accepted its severance deal. Combined with other savings, a potentially rosy reassessment of its pension liabilities by the government and a host of asset sales, it's easy to see why investors view a GM bankruptcy as less likely than they did a few months ago. But the road to recovery is a long one – the carmaker still has a \$19bn hole in its balance sheet.

The buyout plan helps the car business, which could burn more than \$4bn in cash this year – not including a \$3.8bn one-time

charge for shedding staff. Removing these hourly workers means GM can cut about \$3.5bn annually in costs, Merrill Lynch estimates. It removes excess capacity, which is crucial given GM's swift market share declines.

If it gets the manufacturing business close to 3% operating margins, the unit may be worth \$32bn. And GM has other assets: it should have some \$25bn of cash by year-end, thanks to the sale of a 51% stake in finance arm GMAC. Add on the \$7bn book value for GM's remaining stake in GMAC, and GM's assets stand at around \$64bn.

GM's also made some progress with its liabilities. Its long-term pension and healthcare obligations to Delphi now look closer to \$6bn than \$12bn. Most importantly, there is talk the Pension Benefit Guaranty Corp, a government body, has backed down from its estimate of a \$31bn deficit at the end of 2004 if GM filed for bankruptcy and terminated its pension plan. GM estimates the combined shortfall of its US and international plans are just \$4bn.

Unfunded healthcare liabilities at the moment amount to \$46bn. But if GM strikes a healthcare deal with active workers similar to the one its retirees accepted last year, it could perhaps lop off another \$5bn. Folding into that its \$32bn of debt and GM's liabilities may come to about \$83bn – or about \$19bn more than its assets.

Under this best-case scenario, the hole is half the size as it appeared earlier this year, largely the result of the PBGC's apparent softening. But there are still big risks: another round of industry sales incentives looks likely, GM's product line is still highly dependent on fuel-guzzlers and the US consumer looks to be maxing out. GM's restructuring plans are bearing fruit, but it's still deep in the woods.

June 27 2006

Big One

By Rob Cox

The survival of the American car industry requires the barons of Detroit to think radically – something they've thus far avoided doing. Now is the time for their conservative minds to consider something truly revolutionary: a merger of General Motors and Ford Motor.

That may sound wacky. After all, how could antitrust watchdogs ever consider such a deal? And the complexity is enormous – probably far beyond the capabilities of both companies' managers. They're fighting for their jobs as things stand.

But it bears serious consideration. The Big One – as a GM-Ford combination might be dubbed – would be in a much stronger position to tackle legacy costs in bargaining with unions, suppliers, healthcare providers, dealers and the government than they presently are today as fierce rivals.

The savings would be tremendous – far larger than anything Nissan-Renault presents. If a merged GM-Ford reduced costs equal to 2% of sales – one common M&A benchmark – the capitalised value of the savings could be some \$40bn, well above their \$30bn of combined market cap today.

Antitrust issues would have been a hurdle in the past – but not today. In March Washington approved the Maytag-Whirlpool combination despite it commanding 70% of the washer-dryer market. Because GM and Ford have witnessed precipitous dips in their competitive positions, they have just about 40% of the auto market.

Moreover, as Japanese – and even Chinese – rivals expand production in the US and fire up investment, that decline is likely to continue. Toyota's annual capital expenditure is already as large as a Ford-GM combo. Yet it has fewer models to develop

because it has only three global brands. GM and Ford have nearly two dozen. Because a merger would only make sense if it eliminated entire brands – such as Buick, Pontiac and Mercury – further market share losses would also be anticipated.

Of course, the unions wouldn't like any of this. They might even strike. And dealers would need to be paid off. As a united force, though, the Big One would be well placed to negotiate with both. And it has cash to weather many storms. The likely alternative is a slow and painful decline. In the long run, that's probably worse for workers, car salesmen, investors – and America. Bring on the Big One.

July 14 2006

Big One redux

By Rob Cox and Antony Currie

It's easy to imagine a finale to Daimler's disastrous American road trip. Why not hand over its money-losing Chrysler division to the biggest carmaker in the world – General Motors? By crunching plants, models and brands, there would be huge cost savings. They might even create value for investors.

Here's how a deal might work. Daimler hands Chrysler over to GM. The two agree on a value for the business – something like \$10 billion give or take a few billion depending on Chrysler's liabilities. In exchange, Daimler gets no cash, but a big stake in the combined GM-Chrysler. Daimler is, after all, used to holding investments in public companies like EADS, the defence concern. This gives it an option on a Detroit turnaround.

Daimler also hammers out an alliance with GM along the lines of the one Carlos Ghosn fashioned between Nissan and Renault – and tried unsuccessfully to bring GM into. Because

Daimler needs such an arrangement as much as GM, the Detroit carmaker's bosses would be in a position of equal strength in negotiating a deal. By combining procurement, purchasing and some other functions around the world, everybody wins.

Now comes the hard part – and the reason a deal might never get beyond an investment banker's spreadsheet. For a merger to work, GM and Chrysler would need to crunch costs like crazy. Again, on paper this is conceivable. There are overlapping brands, dealer networks, factories, operating plants and white collar workforces galore.

If they cut costs equal to 2% of sales – a common M&A metric – the savings, once taxed and capitalized would be worth about \$30bn – roughly equal to the two carmakers' value. But pushing these cuts through won't be easy. For starters, neither firm has shown much stomach for eliminating brands, although with so much overlap in the SUV market between them they'd have little choice.

Dealing with the fallout from the unions could be harder. A merger would require firing many thousands more than the 13,000 staff Chrysler's latest restructuring plans. Then there are the dealers. Much as they grumble about Detroit pushing them to take in too many vehicles, they won't relish having so much supply suddenly taken off the market.

That's not to say a deal is impossible. But neither GM's nor Chrysler's executives have a reputation for successfully managing the nitty-gritty challenges a deal would present. Unless they can convince their shareholders otherwise, a merger looks like a long shot.

February 16 2007

Plugging the gap

By Antony Currie

For all its recent success, General Motors still looks like a long-term candidate for insolvency. Detroit's largest carmaker has slashed costs, and reported its third quarterly profit in a row today. But healthcare costs leave GM with an \$11bn hole in its balance sheet.

Could a deal to hand those over to the UAW solve the problem? GM won't say, but the idea is thought to be on the negotiating table now. GM would fund an independent trust, administered by the union, to manage all its expected healthcare costs. The company would no longer carry them on its balance sheet. And workers wouldn't risk having their benefits reduced, or eliminated, if GM filed for bankruptcy. What's more, GM could fund the trust at discount, in return for providing cash up front.

Other companies have struck similar bargains. Goodyear secured a one-fifth discount, while bankrupt car-parts maker Dana lopped off 27%. But those two were trying to offload only about \$1bn each. GM has \$64bn on its books.

Of that, \$14bn or so is for non-UAW members' healthcare and would remain a liability. If GM secures the same deal for current workers as it did for retirees two years ago, it could pare \$4bn from the remaining total. Then factor in a discount – say 25% – for financing the new trust up front. That would leave GM having to find some \$34.5bn.

It already has an \$18bn healthcare slush fund. Once it sells its Allison Transmission unit for \$5.6bn, it will have a total of \$26bn of additional cash, although it needs \$15bn of that amount to fund its turnaround, according to Goldman Sachs – so it could probably set aside \$11bn.

That would leave \$5.5bn more to raise. If GM covered that amount by selling debt, it would have \$60bn of liabilities.

On the other side of the ledger, its car business, once restructured, could be worth some \$36bn, assuming it cranks out a 3% operating margin. Fold in its remaining cash, pension surplus and its stake in GMAC, and GM's assets will be worth \$64bn.

Of course, it may not reach a deal. Union retirees, who account for the bulk of GM's healthcare bill, don't have to negotiate for another four years. And the UAW might not give it as generous a discount as Goodyear and Dana enjoyed.

But if GM succeeded, it would mark a significant step away from insolvency. Unfortunately, it would still be worth far less than its current \$18bn market capitalization.

June 31 2007

Chapter 3 – Crashing into the credit crunch

Ford focus

By Richard Beales

It's a winding road for the two biggest US car manufacturers. Around three years ago, General Motors and Ford were hit by a sudden credit scare. Investors initially saw GM as most vulnerable. Then boss Rick Wagoner got moving on a turnaround plan. In June 2006, it dawned on the credit markets that Ford was behind the game. Credit default swaps on Ford, for the first time in years, started trading wider than GM's, implying a greater risk of default.

That's the way it has stayed, barring one momentary blip, until now. CDS markets have, for the last two weeks, once again been giving Ford the benefit of the doubt over GM, according to CDS data provider Markit.

Bill Ford brought former Boeing executive Alan Mulally in as chief executive in September 2006 to help sort out Ford's myriad problems. The recent deal to sell Jaguar and Land Rover to Tata Motors is one outward sign of his progress streamlining the business.

Some analysts also found evidence of accelerated cost-cutting in Ford's announcement of a surprise first-quarter profit. Mulally himself pointed to improvements from the restructuring of European and South American operations.

All this may help justify the change in the credit markets' relative view of Ford and GM as carmakers. Unlike the companies' stocks, their CDS instruments distinguish between that business and their financing arms. Ford Motor Credit never diversified into the mortgage lending that is battering GMAC, the finance unit 49%-owned by GM.

The short-term outlook is tough for the two car making giants and their financing arms. They face stalling or negative economic growth and rising consumer credit problems in the US. Ford, perhaps more than GM, remains exposed to the shift away from pick-ups and big SUVs as American drivers respond to high fuel prices. Both companies' CDS premiums are hovering not far from 10 percentage points a year, which still reflects a considerable risk of default.

Still, it looks like Mulally is earning his spurs with investors – something evident in Ford's stock price over the last month or so, too. GM might impress when it reports next week. But for now, Ford's turnaround appears to be edging ahead.

April 24 2008

Forced into reverse

By Antony Currie

Fortune just doesn't smile on Detroit. No sooner do Motown's carmakers make a decent stab at tackling their huge legacy burdens than along come a stagnant US economy and spiralling commodity prices to throw a spanner in the works. These have brought back the spectre of a Chapter 11 filing – especially for General Motors.

America's largest carmaker appeared to have shrugged off any lingering fears of impending bankruptcy last autumn after offloading its legacy healthcare commitments for around 70 cents on the dollar – as did Chrysler and Ford. That, combined with two years of cost cutting, seemed to leave it in half-decent shape to weather a short, sharp recession.

But now those worries are returning. GM's credit default swaps imply a greater risk of bankruptcy than Ford's – and its smaller

rival also now sports a stock market value almost 50% higher than GM's.

Blame the defunct housing market and soaring petrol prices. These have sent sales of pick-up trucks and SUVs – Detroit's big money spinners – tumbling some 25% since last year. Raw material costs have spiked – steel has almost doubled in price. And foreign rivals dominate the market for smaller cars, making it difficult for America's manufacturers to raise prices without losing market share.

GM isn't the only one affected. Just weeks after posting a surprise first-quarter profit, Ford admitted it's unlikely to meet its target of turning a profit next year. But Ford stuffed its coffers before the credit markets crashed. It now has some \$29bn in cash, almost double what it's expected to burn through in the next couple of years.

GM seemed to have covered itself well, too, selling assets before the buyout markets skidded to a halt. But the combination of cash burn and maturing debt could leave it with less than \$1bn by 2010, according to Lehman Brothers. Even if it taps its bank lines, it will still have less than the \$10bn or so analysts reckon car companies need on hand as working capital.

GM has laid off another quarter of its US shop floor workers this year, is closing four plants and may sell its gas-guzzling Hummer brand. But unless it can persuade jittery investors to stump up a lot more cash soon, the biggest member of the Big Three will again be stalked by the threat of bankruptcy.

June 3 2008

You wish I was yours to command

By Antony Currie

A frustrated General Motors executive fills up his company Suburban with gasoline. Suddenly, an apparition emerges and introduces himself as the Genie of the Tank. He grants the executive his one wish – to run a profitable car company – and promises to conjure it into existence using whatever elements of GM the executive chooses.

The executive draws up a list. To keep it simple, he christens his new company Focused Motors to break with the blunderbuss approach that landed GM in its current hole. Next, he chooses vehicles. He knows he must turn GM's dependence on gas guzzlers on its head – trucks and SUVs constitute roughly 60% of U.S. sales – and produce fewer models. He recalls that Toyota makes just eight models in the US. GM has 70-odd across its eight brands. He reckons as many as 20 models may be a good starting point, and all under its two strongest brands, Cadillac and Chevrolet.

Next, he assembles a work force. He estimates 36,000 in total. That is the same as Toyota employs in the US, and much less than the 54,000 or so union workers alone at GM. And no special deals on health care or pensions.

He also will need only a fraction of GM's 7,000 dealers. Using Toyota as his yardstick he plumps for around 1,500. Finally, he throws in a request for no debt, and \$12bn of GM's cash for supplies, research and emergencies, hands his list to the genie and shazam! He is in charge of a successful manufacturer with a 6% operating profit margin selling as many as two million vehicles a year.

If only it were so easy for GM boss Rick Wagoner. GM may need \$15bn of fresh cash just to make it to 2010. That is without culling brands, which can be expensive. But to be

profitable, GM surely needs to shrink. As it stands, without a touch of genie magic, filing for bankruptcy-law protection may be the only way it can achieve that goal.

July 8 2008

Chapter 4 – The case against a government bailout

First, do no harm

By Richard Beales

The three big US carmakers are angling for government help to the tune of \$50bn. It's understandable: they are struggling and policymakers have thrown money at financial sector basket-cases. But Chrysler, Ford and General Motors shouldn't get handouts.

Aside from the cost to taxpayers, a government safety net for companies discourages prudent management. It also potentially puts rivals at a disadvantage, making markets less efficient and ultimately hurting consumers. That doesn't mean policymakers should never, ever, step in. But the test should be whether the alternative is disastrous enough to justify intervention.

Take the blank cheque Congress recently wrote to backstop mortgage giants Fannie Mae and Freddie Mac. It is disheartening to see taxpayers' money put at risk. But the alternative was probably a near-seizure of the already beleaguered US mortgage market – a horrendous outcome for millions of American homeowners.

The Federal Reserve's role in the Bear Stearns rescue is a tougher call. Despite its relatively small size, financial regulators judged that the Wall Street firm's failure would have torpedoed already fragile markets, triggering severe pain for the economy. We'll never know if that judgment was correct. But the Fed felt it had to act decisively.

As for GM and its fellows, Congress in last year's energy bill paved the way for \$25bn in cheap loans for developing and manufacturing fuel-efficient vehicles. There's an argument that

this balances research and other spending by foreign governments whose cost would otherwise fall on Detroit's rivals. But with the Big Three short of cash, it's hard not to see it partly as a bailout. In any event, the US carmakers are now hoping for more, perhaps with fewer strings attached.

It's true that they are big employers. But foreign manufacturers like Toyota also have tens of thousands of employees in the US. Financial support for the US firms would undermine longstanding American criticism of countries that subsidise "national champions". It would also set a precedent for other industries to raid taxpayers' wallets.

Moreover, the U.S. car companies' problems are largely of their own making. They didn't invest enough in smaller, more-efficient vehicles when they could have. Now that higher energy costs have finally caught up with them, it is unconvincing to say the government should help them meet the tougher fuel-economy regulations they have long opposed.

There's also no looming Armageddon as there was, say, for Bear. Detroit's car crash is happening in slow motion. Motown's fading stars need a fresh start. There's a process for that: it's called Chapter 11. In bankruptcy, the carmakers' executives, shareholders and probably creditors would suffer, as they should. Sadly, some employees would also lose out, but that has been happening anyway. The endgame might be a sale to a US or foreign rival – but maybe consolidation is what the industry needs.

Government loans or guarantees – which reduce funding costs – aren't really justified by the credit drought of the last year, either. Lenders have been wary of US carmakers on and off for years because they haven't been able to make cars profitably. In GM's case, too, there's the danger of further costs relating to parts maker Delphi, the former GM unit struggling to emerge from its own bankruptcy.

On a historical note, even the Carter administration's bailout of Chrysler beginning in 1979 – viewed by many as a success – bought only limited breathing space. The company was sold to Daimler in 1998 and then, after costing the German group billions, to investors including private equity outfit Cerberus Capital Management last year.

In an election season, the Detroit carmakers might get lucky. The possibility of such industrial favoritism seems more characteristically French than American. The French, however, might well force the three to merge, throw out two sets of executives and pay the remaining group a lot less. That probably isn't quite what Detroit's bosses have in mind.

September 1 2008

Steer clear

By Antony Currie

The US government should be careful where it parks any taxpayer money in Detroit. General Motors' woes have become so severe that boss Rick Wagoner is now personally lobbying lawmakers to treat the carmaker much like a bank and hand over up to \$12bn to help fund a mooted merger with fellow struggler Chrysler. Acceding to his pleas risks throwing good money after bad.

General Motors, its intended partner and Ford all suffer from long-term, chronic problems. GM is locked out of the capital markets and at current rates will burn through its cash by mid-2009. Worse, market turmoil may leave its pension plan with an \$18bn deficit this year, according to JPMorgan. Filling that hole alone would tip the company over the edge.

Nor are the benefits of a merger with Chrysler clear. True, the two could cut \$10bn of overhead – which would carry a net

present value to shareholders of perhaps \$60bn, almost 20 times GM's current market capitalisation. And Chrysler has around \$9bn of cash on hand. But merger costs would eat up more than that – which is why the two are so desperate for government aid. Also, GM hasn't pared back its own swollen cost base enough yet, including its many brands and models – several of which compete with each other – as well as its dealers.

The trouble is, even if Wagoner had the money, he has given little sign he would take aggressive-enough steps. So GM and its rivals might not survive as going concerns even with the extra cash. If it hews to its policy of only supporting viable companies, the government would let them go under, like Lehman Brothers and Washington Mutual.

That doesn't mean no help would be forthcoming. Federal aid could be a crucial source of debtor-in-possession funding once the Motor City manufacturers file for Chapter 11 protection. That would give the government additional leverage to push for extensive changes. And in an echo of its moves to guarantee bank debt, the government could promise to honour the carmakers' warranties and thus quash fears that few would buy a bankrupt manufacturer's vehicles. Bankruptcy wouldn't be pretty. But for the car industry at least, it would be the best place for Uncle Sam to put his money to use.

October 28 2008

Panic in Detroit

By Dwight Cass

The US carmaker bailout is skidding down a slippery slope. To rescue General Motors, the Treasury has now ponied up \$6bn to prop up its finance affiliate, GMAC. But for GMAC to crank up its lending, the Federal Reserve may have to take a liberal view of its capital levels. There are other disquieting signs the Treasury and Fed are not totally in accord, which may further damage their credibility.

The Fed imposed tough conditions on GMAC last week when it approved its application to become a bank holding company, giving it access to oodles of government lending facilities. It required the company to scrape together about \$30bn of equity in order to be “well capitalised” and to cut Cerberus’s and GM’s ownership stakes sharply over time.

But the Treasury seems to be pushing in the opposite direction – \$1bn of the funds it has siphoned from the Troubled Asset Relief Programme has been lent to GM so that the carmaker can participate in an upcoming rights offering by GMAC. That will actually increase GM’s stake.

Of course, there are several reasons the Treasury may have taken this route. The government is already purchasing \$5bn of preferred stock and warrants with the balance of the funds; by lending to GM rather than buying GMAC common stock directly, it gets a higher position in the pecking order if the carmaker goes bankrupt.

More worrying is the possibility that this \$6bn is the first of many trips to the well. After all, GMAC is still losing money – it has haemorrhaged almost \$7.5bn since the start of 2007 – and isn’t overflowing with capital. It had \$9bn at the end of September, is raising \$2bn from shareholders – including the rights offering – and now has the \$5bn in Tarp money.

It just concluded a debt for debt-and-preferred exchange offer, the deadline for which it had to extend several times. It says enough bondholders swapped their debt for it to meet the Fed’s capital requirement. But that doesn’t leave it with a huge amount of excess cash to leverage into new loans, or act as a buffer against future losses.

If GMAC’s woes end up threatening to pull the US taxpayer ever deeper into Detroit’s mire, it’s just one more reason the government should stand firm come March and force the carmakers to restructure under the auspices of Chapter 11.

December 30 2008

Chapter 5 – Prolonging the pain

No it can't

By Robert Cyran

The US government's rescue package for General Motors comes with some ugly conditions attached for debt-holders, union members and the company itself. Chief among these is a requirement that the carmaker demonstrate a plan for achieving a positive net present value. Even with deep cost cuts, debt restructuring and union concessions, a back-of-the-envelope calculation suggests this is out of reach.

Any calculation about GM's worth must start with its debt-laden balance sheet. In return for handing over up to \$13.4bn in emergency loans, the Treasury is calling for GM to wipe out two-thirds of its unsecured debt by swapping it for equity. Assuming lenders agree – a big task in itself – that would leave GM with \$12bn of unsecured and \$6bn in secured debt. Include the government loans and the total jumps to \$31.4bn.

Add to that GM's onerous legacy obligations. First, healthcare costs. The Motown manufacturer has done a good job trying to reduce these in the last couple of years. But it still has to pay \$10bn in cash into the independent fund for UAW members' benefits. And the net unfunded healthcare liabilities for non-UAW workers currently stands at \$8bn, though that's expected to drop as a result of cutbacks announced last summer.

Then there are GM's pension benefits. For simplicity's sake, let's just concentrate on the US plan. That was fully funded at the end of 2007 but it would be astounding if last year's market turmoil in virtually every asset class did not send it into the red. University of Chicago Professor Joshua Rauh estimates GM's plan may now be underfunded to the tune of \$23bn.

That may be too pessimistic, but let's assume the figure is around \$10bn. Because of some tax credits that the company has stored up for previous losses GM doesn't have to cover a shortfall imminently. But add it to the rest and the sum of GM's liabilities hits almost \$60bn.

What does GM have on the asset side of its ledger to offset these liabilities? It will have some \$15bn in cash following the government injection, though its history suggests it could burn through this in no time. Its stake in lender GMAC might be worth, at best, its book value of \$5bn. Stakes in Asian rivals look to be worth another \$5bn. Add these up and GM's car unit must be worth at least \$35bn to meet the government's stipulation that it have a positive net present value.

Can it get there? Analysts estimate GM should have car sales of around \$135bn in 2009. While down from the \$150bn or so the company should have tallied last year, it may also be optimistic when the US economy is contracting and consumers are still heavily indebted.

Well-run car companies, such as Renault, tend to have low margins – indeed 3% constitutes a decent showing in the business. It's possible that GM could achieve something like this, but it won't be easy given all the disruption that may result from concessions with workers, supplier and dealers as it rushes to meet other requirements attached to the government's loans.

Still, if one takes this relatively charitable view of GM's sales and earnings power, it implies about \$4bn in operating earnings. Once taxed and put on a multiple of 10 – which is basically an assumption that the income stream neither grows nor shrinks over the cycle – GM's car business would be worth about \$28bn.

That's not quite enough to meet the requirement that GM achieves a positive net present value, despite hard concessions

by all the stakeholders and a dollop of government largesse. Of course, there's always the chance that pension and healthcare costs will be less onerous. Maybe its pension fund managers did do better than the market – and 90% of the investment management industry.

And the company will no doubt unveil all sorts of other valuation metrics and optimistic projections about cash flows to show the company has a positive value. But by at least this back-of-the-envelope calculation, the government has reason enough to force GM into a bankruptcy filing sooner rather than later.

January 9 2009

Time's up

By Antony Currie

Chrysler and General Motors will fail to meet government-mandated restructuring targets by the end of the month. But the US reportedly intends to give both of them at least another month to wring concessions out of their lenders and unions – and to lend them more money. That's the wrong move. The Obama administration should force them into bankruptcy now.

Sure, on Friday, just days before the deadline, GM reportedly made new offers to both its workers and bondholders in the hopes of slashing its liabilities. But it's not clear either party would accept. The terms GM offered to settle its healthcare bill with the UAW union – granting \$10bn in preferred stock and funding the other \$10bn with cash over 20 years – might not leave the independent healthcare trust with enough of a base to cover its outgoings.

Bondholders, meanwhile, would under one plan receive eight cents on the dollar in cash, 16 cents in new unsecured debt and own 90% of GM's equity. That sounds like the sort of solution

that emerges from a bankruptcy – but it would only be accepted if bondholders thought the company would then survive. If they think a Chapter 11 filing was still likely, there's no upside to swapping senior securities for stock that would be quickly wiped out.

And bankruptcy does still appear to be on the cards. Even if GM strikes an agreement with its bondholders, it still needs emergency aid from the government on top of the \$13bn it has already taken. Its latest plan calls for up to \$22.5bn more, as well as \$7.5bn if car sales don't recover in the next two years, \$7.7bn in energy loans and \$6bn from foreign governments.

In other words, government loans would more than dwarf any debt reduction from bondholders. Credit Suisse, for example, reckons GM could end the year with \$50bn in debt, almost 60% more than in 2008. Annual interest payments would be \$3bn, assuming a blended rate of 6% – \$3.9bn if the independent trust were to take preferred shares. GM would have to generate a whopping 6% pre-tax profit margin on consensus revenue estimates of \$107bn just to cover that.

But GM is still losing money. It could burn through \$30bn in the next three years, according to Credit Suisse. Of course, car sales could suddenly skyrocket and save the day. But that's a big gamble to take with taxpayers' money. Forcing GM – and Chrysler – into bankruptcy now would mean acknowledging losses, too. But at least Motown's manufacturers might be in a better position when the market finally improves.

March 27 2008

Wag-gonner

By Antony Currie

The White House is right to ask for Rick Wagoner's resignation in return for extending more aid to General Motors. That's just how this pseudo-bankruptcy should work – the ailing carmaker would already be in Chapter 11 if the Washington hadn't stumped up \$13.4bn in emergency aid. But changing drivers is only a first step. The government needs to show that it has a credible longer-term plan that puts GM back on the road to sustainability and protects as much taxpayer money as possible.

That's already looking tough. Even if GM's new boss is able to strike a deal with bondholders to slash the company's unsecured debt, the amount of government cash to keep GM afloat will soon dwarf any savings. Credit Suisse estimates GM's debt will balloon by almost 60% this year to \$50bn and hit \$53bn next year.

Yet the company won't report a profit until at least 2012. Sure, the Swiss bank's analysts reckon ebitda might at least turn positive next year, at \$4.5bn. But that would barely cover interest payments and any dividends on preferred stock used to finance its gargantuan healthcare bill. And it would leave GM almost 12 times leveraged. That's much more debt than private equity firms were willing to consider putting on even vaguely healthy companies they bought at the height of the credit bubble.

In other words, government aid is making a terrible situation even worse. It would take an optimist of Panglossian proportions to believe that GM will be able to generate positive net present value – the main condition in return for receiving the first infusion of aid back in December.

Let's assume car sales recover quickly and GM's revenue hits \$150bn – 40% more than this year's Reuters consensus estimates. GM would need to generate a pre-tax profit margin of 4% just to pay interest and dividends. Even an industry-leading 6% margin would only leave an extra \$2bn a year to pay down its debts.

That doesn't mean Wagoner's exit is irrelevant. As boss for almost nine years and chief operating officer, finance chief and head of North America in the preceding decade, he is the public face of the company's failure. But the government must also impose much more radical surgery if GM is ever to come off life support. It's hard to see how it can do that outside the confines of a true bankruptcy filing.

March 30 2009

Bad and worse

By Antony Currie

The US's treatment of domestic carmakers must leave Motown feeling hard done by. After all, Bank of America and Citigroup has each received more than double the amount of direct government aid that Chrysler and General Motors have between them. Yet neither megabank is staring enforced bankruptcy in the face. But Detroit's woes do, in fact, call for a more heavy-handed approach from Washington than Wall Street.

Sure, Motown can point to some egregious bailout examples in the financial sector that seem to confirm favouritism, especially the \$180bn handed to American International Group in several installments and apparently with few questions asked – a mountain of taxpayer money that is unlikely to be repaid in full. And banks are guilty of excesses that need taming, including pay mechanisms that rewarded excessive risk-taking.

The AIG fiasco shouldn't be seen as a model to follow. And most other financial firms are far from getting away scot free. Some mostly smaller ones have been allowed to fail. For others, the precipitous drop in the sector's stock prices has slammed shareholders, including employees. And some 430,000 finance jobs have been lost in the last two years, according to outplacement company Challenger, Gray & Christmas.

Of course, stakeholders in Motown's manufacturers can point to similar pain and sacrifice. And both industries can claim that illiquid credit markets are really to blame for their trouble.

But letting a big bank fail can have a bigger and much more immediate effect on the economy, as the collapse of Lehman Brothers proved. GM spun the line that its bankruptcy would have similar ramifications – but executives have since dropped that argument. In any event, the government has already taken steps to help alleviate the consequences by guaranteeing warranties and setting up a programme to backstop payments to suppliers by Detroit's Big Three.

Fear of the domino effect of a bank collapse isn't the only factor driving the different approach, though. Financial firms have much more flexible cost structures: they can shed staff and office space quickly to help restore profitability. GM's most recent restructuring plan, on the other hand, had a five-year time frame – and the writing has already been on the wall for Detroit's broken business model for at least five years.

Also, as liquidity returns, some financial asset prices should recover, meaning banks might recoup some of their losses. Chrysler and GM cannot pull that trick with car sales – in fact, they usually offer discounts to shift any excess inventory, which increases their pain.

That means GM and Chrysler are less likely to be able to pay back the government than most banks – in fact, a handful of smaller firms already have, while the likes of Goldman Sachs and JPMorgan would like to once the Treasury's stress tests are completed. The government should make sure those tests are tough enough. But overall, the intractability of Detroit's problems justifies the sterner treatment. It might sound harsh, but it's fairer than it looks.

April 3 2009

Third time doesn't charm

By Antony Currie

General Motor's latest restructuring effort looks like its first real stab at Chapter 11-style reorganisation – minus the name. New chief Fritz Henderson's plan lays out more cost cuts and brand reductions, offers bondholders a chance to swap their securities for equity and even proposes the US government exchange half its loans for stock. But that still might not be enough to avoid bankruptcy.

For starters, the revamp would leave the biggest single group of creditors taking the most pain, perhaps increasing their willingness to take their chances in a proper Chapter 11 filing. It's not necessarily that holders of \$27.5bn of unsecured bonds would get just equity and no cash – that looked increasingly likely in recent weeks.

It's that they would receive just 10% of the restructured company. Meanwhile, in return for each giving up just \$10bn each, the trust set up to cover United Auto Workers' healthcare costs would own 39% and the US government could wind up owning at least half of a reconstituted GM. That may be enough of a disparity to persuade sufficient numbers of bondholders to

reject the plan – and GM executives reckon anything less than a 90% acceptance rate spells bankruptcy.

But even if bondholders do accept, GM's balance sheet would still be laden with liabilities: around \$6bn of secured debt, loans of at least \$10bn from the government – with more aid likely in the next year or so – and the Motown manufacturer may soon owe perhaps another \$6bn to foreign governments. What's more, GM would still be in hock to the UAW healthcare trust to the tune of \$10bn and still holds \$8bn or so of unfunded non-UAW healthcare liabilities.

Sure, the most recent bout of proposed cost cuts is encouraging – the company aims to slash \$7bn from annual fixed costs by shuttering its Pontiac marque, laying off more staff and closing more plants and more dealers than envisioned in its February plan. And it would do all of this more quickly than promised in the past.

But the plan would still leave GM with at least \$40bn of liabilities, very little cash and virtually controlled by the federal government. Even GM estimates it will fail to achieve a net present value if industry-wide car sales do not top 15.3m in the next few years – up from around 9m today.

That leaves it precariously positioned for the foreseeable future and leaves the value of any new equity in question. For some creditors, bankruptcy might still seem like the less worse option.

April 27 2009

Bailout America

By Rob Cox and Lauren Silva Laughlin

It's politically expedient for President Obama to blame recalcitrant hedge funds and "speculators" for forcing Chrysler into bankruptcy. But they were right to just say no to the US government's restructuring plan, which treads on the rights of senior creditors. Caving in to Uncle Sam would have set a bad precedent for capitalism – and may ultimately hamper the president's exit strategy from Bailout America.

Technically it's true that a small group of investors, holding \$1bn of \$6.9bn of Chrysler's debt, played a pivotal role in deciding Chrysler's fate. By not accepting the 33 cents on the dollar they were being offered by Obama's automotive task force, the carmaker had no choice but to file for protection from its creditors.

But it's questionable whether Chrysler would have avoided bankruptcy even if the group had accepted the offer. Bankruptcy allows Chrysler to wrangle greater concessions from dealers, which notably eases Fiat's arrival, and ultimately makes Chrysler a stronger company. Solely blaming the hedge funds is disingenuous.

And even if Chrysler could have accomplished its aims without reverting to Chapter 11, the government's offer alone was reason enough for creditors to resist – and continue to press their case in the courts. Under the government's last proposal, the lenders would have received \$2.25bn in cash, implying a 67% haircut.

Despite being an unsecured creditor, however, the United Auto Workers is poised to retain half of Chrysler's \$10.6bn obligation to the union. That means the UAW gets 50 cents on the dollar even before accounting for the 55% stake in the new Chrysler-

Fiat that it is receiving. Equity is obviously riskier than debt, but it's conceivable that the UAW will be made more than whole.

Politically speaking, this would be a great outcome for the president. But the message it sends to lenders is quite clear. Years of bankruptcy law have put secured creditors at the top of the pecking order, inducing them to put capital at risk. Vilifying investors who held firm to this conviction may have the reverse effect.

April 30 2009

Debt again

By Antony Currie

General Motors' creditors aren't out of the woods yet. The ailing carmaker's most recent restructuring plan may well look draconian already, aiming to exchange up to \$48bn of union, bondholder and US government liabilities for stock. But even if the plan goes through, GM will still be left with as much as \$50bn in debt.

How? Well, it still has \$6bn of secured debt, will still owe \$10bn to both the government and the UAW workers' independent healthcare trust and executives reckon they'll need another \$9bn from the US to cover more losses. Add to that \$11bn of expected loans from the US Department of Energy and foreign governments and \$3bn of unsecured debt, assuming 90% of bondholders accept the equity swap.

To have an enterprise value that supports such a hefty debt load and leave something for shareholders, GM would have to generate some \$13bn in cashflow a year. Put on a similar multiple to peers of four times ebitda, that would imply an enterprise value of \$52bn.

That would value the stock at just \$2bn, which would be fine if that were achievable in short order. But GM won't hit that until 2013, according to Barclays Capital. And that's assuming GM's cash burn estimates are accurate.

What's more, finance chief Ray Young says he'd like GM's debt burden to be no more than two times ebitda. That means GM would have to cut its new debt load in half based on 2013 numbers. Detroit's number one carmaker won't be able to do that by selling cars. That leaves executives with little option but to inflict more pain on its workers and lenders – including taxpayers.

May 7 2009

Scapegoat-herd

By Dwight Cass

Recalcitrant creditors were made scapegoats for the collapse of Chrysler. They may play the same unhappy role if General Motors runs off the road. GM bondholders who have hedged their exposures are said to want the US carmaker to file for bankruptcy. But that doesn't make them opportunistic speculators.

If GM files, these investors may indeed collect on their credit default swap contracts. But in many cases, they've already suffered big losses on their bonds. Making up for those is what hedging is all about.

Meanwhile, the government-inspired plan looks like a raw deal. Lenders would only get 10% of GM's new equity, rather than the lion's share which, as the largest block of creditors, is arguably their due. And it's not certain GM's latest restructuring plan will work anyway.

It's also unlikely most of the bondholders concerned are short-term speculators. The economics of hedging GM's bonds haven't looked attractive in a while.

The last time it made good sense was probably in early 2007, when GM's bonds looked somewhat healthy and fetched around 97 cents on the dollar. An investor seeking to hedge \$10m of those bonds for five years would have paid about \$390,000 a year, a cost covered by the interest received on the bonds. By last summer, that bondholder had lost 10%, or \$1m, on the bonds, but that was roughly offset by the increased value of the CDS contract.

But then the carmaker's wheels started coming off. The reported upfront cost of CDS protection ballooned to \$8m by the end of last year, in addition to a \$500,000 annual fee, and the bonds plunged in value to about 25 cents on the dollar. Buying the bonds then and insuring their \$10m face value would cost \$11m in the first year – a losing proposition even if GM were to default.

So the hedged bondholders have probably been in the game for a while. They may have the advantage of protection against a GM failure. But there's little reason to excoriate them for risking a GM bankruptcy when the alternative deal on offer is so meagre.

May 12 2009

Detroit sinkhole

By Antony Currie and Rob Cox

American taxpayers are about to become the majority owners of General Motors. So it is only fair for them to ask how, or whether, they will ever recoup their investment. Unfortunately, the odds of the US government receiving anything close to the sums it will wind up shovelling into the struggling carmaker aren't particularly high.

Uncle Sam is already on the hook for some \$20bn and plans to transfer half of that to a restructured GM balance sheet. Add the rest to the debtor-in-possession financing Washington is to provide for what it hopes will be a short bankruptcy process and taxpayers will be owed at least another \$50bn.

For that commitment, the Treasury expects to wind up owning 72.5% of GM's equity when it emerges from Chapter 11. The remainder goes to the United Auto Workers union and unsecured creditors - mostly bondholders. The latter will also receive warrants that can give them up to another 15% of the equity as the company's value increases.

Crudely speaking, for the government's stake to match the \$50bn in loan commitments, the post-bankruptcy GM's total equity would have to be worth at least \$69bn - more, assuming bondholders exercise their warrants. This calculation also does not factor in the time value of money.

GM's market cap only reached around \$60bn back in its heyday in 2000 when the Motown manufacturer reported about \$21bn of earnings before interest, tax, depreciation and amortisation. That was when low gas prices fuelled profitable SUV sales; GM had eight brands and a massive captive financing business, GMAC, which brought in a third of earnings.

The New GM, as the government is calling it, will only own a sliver of its financing arm. It will have ditched the Pontiac, Saab and Hummer brands. And the New GM is expected to lose control of both its European arm, which had sales of \$34bn last year, and its Latin American businesses.

So for taxpayers to be made whole, the new mini-GM would have to produce earnings sufficient to support an enterprise value of at least \$95bn - the sum of a \$69bn market cap and its \$26bn of consolidated debt and preferred stock. Using market valuation multiples of five times profits, that means New GM must generate ebitda somewhere in the order of \$19bn annually.

That would require boosting annual sales to some \$150bn - almost 50% more than the entire company is expected to generate this year - and matching the whopping 14% ebitda margin that Toyota achieved in its best year ever. It requires a vast leap of faith – or an audacity of hope – to believe that can happen.

Of course, the US government is not a professional money manager. The decision before it was not whether to invest either in GM or another business that would generate an acceptable return. It had to weigh up two unpalatable choices: throw taxpayers' money onto GM's bonfire in the hope an expedited trip through the Chapter 11 mechanic's shop would produce a souped-up, successful carmaker; or risk having to mop up a bigger mess if a liquidated GM brought the entire US car sector down with it.

May 28 2009

Calculator

Use our calculator to work out which group is most likely to get their money back - and how well GM needs to do for that to happen.

[Run the numbers](#)

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