



GM on the Highway to Bankruptcy

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GM will be forced into bankruptcy. An additional \$15 billion in aid from Congress could mean it happens at the end of March rather than in the next few weeks, but even with a government bailout, the auto giant's bankruptcy is a question of when, not if.

Testimony in Washington last week, in front of both Senate and House committees, confirmed that, barring government aid, GM's cash position will force a bankruptcy filing this month, either because of lack of liquidity or a breach of debt covenants.

A glaring lack of understanding among lawmakers, much less consensus, sealed GM's fate.

On Thursday, the CEOs of the Big Three testified in front of the Senate Banking, Housing, and Urban Affairs Committee, chaired by Chris Dodd (D-CT). A reasonable line of questioning would have been to begin with the fact that only GM's situation was critical, determine how GM could achieve solvency on a long-term basis, and decide if the taxpayers should underwrite the expenses necessary to bring about that goal.

What actually transpired in the Thursday session, and during the Friday session in front of Barney Frank's (D-MA) House Financial Services Committee, was a far cry from anything that rational.

On Thursday, for example, Chairman Dodd became inexplicably fixated on issues such as why the automakers were taking inordinately long to send rebate checks to auto dealers in his home state of Connecticut and why the Big Three were not more focused on the market for minibuses, given the need mass transit. There was an extensive discussion, led by Senator Schumer (D-NY), over whether a committee or an individual trustee should manage oversight of a workout period. And we saw a renewed discussion of how the CEOs had traveled to Washington, whether they carpooled, and what their plans were for returning home.

Friday's session focused even less on key issues. Representative Al Green (D-TX) offered a sermon on why the auto industry was vital to our national interests. There was continued discussion of the plight of auto dealers — a highly



troublesome issue that deserves attention, yes, but absent was any discussion on the economics of GM's business model. To instead focus on peripheral issues like the solvency of auto dealers is a classic case of treating the symptoms rather than the disease.

Only senator Bob Corker (R-TN) seemed to have done the necessary research to grasp the central issues and ask the right questions. On Wednesday, Ron Gettelfinger, President of the UAW, announced that the union would make two concessions — postponing GM's required contributions to the workers' health care plan (VEBA) and eliminating the highly contentious Jobs Bank program. While most committee members offered nothing but compliments to the UAW for these concessions, Corker took a different view, saying the following:

“The problem is you [Mr. Wagoner] have this built-in problem that's not going to be solved unless it's forced to be solved. And there's no way that Mr. Gettelfinger – there's no way he's going to sit down and do the things that he has to do to make you competitive, unless he knows the end game is bankruptcy. He's not going to do it. It's not possible... He can't make it happen with his membership without that happening.”

Mark Zandi, Chief Economist with Moody's Economy.com, testified on Thursday and seemed to understand the economics of the auto industry better than the CEOs who sat alongside him. In his testimony, which we have posted on our [site](#), Zandi said the \$39 billion in funding requested by the automakers would be inadequate, and a more realistic figure would be \$75-125 billion, depending on the severity of the recession. Even this, he added, would only ensure that bankruptcy would be averted for the next two years.

The chasm between Zandi's numbers and the \$39 billion requested by the auto executives lies partly in different projections for the auto market and partly in some questionable assumptions on GM's part. One such assumption is the automakers' forecast of a stable market share. Zandi's data reveals a steady, almost predictable, decline in market share over the last two decades. To expect this decline will suddenly halt, especially in the context of the Big Three's financial troubles, is virtually beyond reason.

GM's plan also contains the highly problematic assumption that its debt holders will make unilateral concessions without a quid pro quo from other stakeholders.

GM probably requested only \$25 billion in the previous round of hearings because they realized that requesting a figure as high as Zandi's would be a nonstarter. Requesting as much as \$75 billion in this round of hearings would have destroyed GM's credibility. .



Zandi's analysis largely agrees with the analysis we presented last week in our article, [How to Fix GM](#). Disturbingly, very few of Dodd's committee members directed questions to Zandi, instead choosing to interrogate the CEOs. Either they were willing to accept Zandi's findings (unlikely), they found it more valuable to share the limelight with the Big Three CEOs, or they sought to avoid a confrontation with the UAW over whether Zandi's analysis implied big concessions from the union.

Lawmakers also demonstrated poor judgment in heaping praise on Gettelfinger. His concessions, while generous and productive, actually increase the likelihood of bankruptcy. As negotiations progress, Gettelfinger can assert that the UAW has already made broad concessions and should not be asked to go any further. But Zandi's analysis and ours indicate that GM cannot achieve long-term solvency even with these preemptive concessions.

GM's CEO, Rick Wagoner, likely believes bankruptcy is in the best interests of his shareholders. Bankruptcy would force renegotiations of all labor contracts and would put debt payments on hold, preserving what little value may be left for GM's equity holders. In continued negotiations without bankruptcy, on the other hand, Wagoner may see a path of value destruction for equity holders. But for Wagoner to publicly advocate bankruptcy would be a public relations nightmare.

Wagoner asserts that bankruptcy would stop car purchases by potential buyers – a view that was echoed throughout both days of hearings. But if customers would not buy a car from a bankrupt company, they probably won't buy one from GM today. So it is hard to take Wagoner's assertion at face value.

Given the lack of understanding of the key issues on the part of congressional leaders, the position staked by the UAW, and what may be in the best interests of GM's shareholders, it is now certain that bankruptcy courts will resolve GM's fate, not Congress.

Momentum is gathering behind a plan to provide a \$15 billion loan to the automakers to stave off bankruptcy. It will buy some time, but GM will remain a cash-burning machine — it cannot forestall the inevitable.

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