

It's Hard to Give Away Risk, Part II

Take My Company. *Please*, Take My Company!

Poor General Motors. The former envy of the automotive world has become the Rodney Dangerfield of the industry, unable to get any respect. The company's market cap, once the largest in the world, has now shrunk to less than \$13 billion, the lowest on the Dow Industrials and less than an eighth of rival Toyota's \$167 billion. As the possibility of bankruptcy looms, its bonds have been classified as "junk" by Moody's and S&P for quite some time now.

So are GM's cars really *that* bad? Well, the facts would suggest otherwise. At time of writing, GM is still the biggest automaker in the world, indicating that the company is still doing a few things right in the eyes of consumers. General Motors is making better, more reliable cars, at more competitive prices than at any time its long history...yet the company continues to bleed cash. The reasons are certainly no mystery; GM is hamstrung by legacy commitments to labor that were negotiated in an economic climate very different from ours today. Specifically, GM is on the hook for an estimated \$90 in pensions and an additional \$65 billion in employee and retiree healthcare liabilities. That's \$155 billion in liabilities for a company with a market cap of a mere \$13 billion that can't turn a profit.

This problem clearly isn't going away, and certainly everyone – stockholders, labor, the Feds – has an interest in keeping GM alive as a viable dividend producer, employer, and taxpayer. This has led to countless, mostly forgettable, proposed fixes. The Wall Street Journal, however, recently printed a solution that is anything if not bold: effectively give the company to labor in exchange for labor assuming the pension and healthcare liabilities. Read on:

Union-Made, Union-Owned? A Plan for GM

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Jesse Eisinger

In the sad decline of the American automotive industry, we have reached the serial restructuring stage.

Every few months Wall Street flirts with hope as Ford Motor or General Motors presents a new plan to cut workers, close plants and rejigger benefits. But the moment is fleeting, as investors revert back to pessimism....

So here's another idea: **Transform GM's workers and retirees into owners in exchange for benefit givebacks.**

Rod Lache, an analyst for Deutsche Bank, has been mulling over such a plan to save GM. Here's how it would work:

GM had a pension liability of about \$90 billion at the end of 2004. Mr. Lache estimates GM has health-care liabilities of about \$65 billion.

That's \$155 billion in liabilities. ... Now let's look at the assets supporting those obligations. The pension plan had assets of almost \$90 billion at the end of 2004. GM says that after investment gains of 13% last year, the plan is overfunded by \$6 billion. The health-care obligations are underfunded to the tune of \$50 billion....

Mr. Lache proposes to give the money that is socked away for pensions and health care to the auto workers. Then, he proposes that GM transfer GMAC, the financing unit, to the workers. GMAC has about \$23 billion in book value. Add that to the existing \$15 billion long-term health-care trust, which employees then manage. **The pension plan becomes an employee-run retirement plan** [and thus the risk becomes theirs to manage – Charles].

OK, that amounts to \$128 billion in assets, leaving workers far short of the \$155 billion in estimated liabilities. The plan needs a sweetener: Give the workers \$20 billion in GM equity. But GM's market value is just \$11 billion today. So, how is that possible?

After getting out from under the benefit costs, GM would be a nimbler competitor. And it would throw off plenty of cash. Indeed, Mr. Lache estimates that...there would be \$31 billion of equity value at the newly restructured company....

In this plan, the workers would get about \$148 billion in assets for the \$155 billion that they are owed. That amounts to almost \$250,000 of value, on average, for the roughly 600,000 active workers, retirees and spouses covered under the pension plan.

To be sure, workers would still come up short \$7 billion and *many older workers would be counting on risky shares in a difficult industry to make up for reduced benefits* [emphasis ours – Charles]. But what's the alternative? It's probably more than they would get after years of deterioration led to bankruptcy. And shares would provide a chance for upside.

"There is almost a universal recognition that the union already owns the majority of this enterprise. This crystallizes it," Mr. Lache says....

As we at HS Dent have already said (see January '06 HS Dent Forecast and the 1/13/2006 Hot Topics in the News), it's hard to give away risk. Mr. Eisinger recommends that General Motors hand off its pension and health assets (along with the profitable GMAC, seats on the Board of Directors, and an enormous amount of company stock) to the United Auto Workers. While this (arguably) would be a major relief to GM, what now happens to the union? When the United Auto Workers are unable to meet their new obligations to the retired workers, to whom will they toss the "hot potato" of risk? Will they use their power on the Board to force GM to make up the difference? Perhaps. Most likely, it will be the Federal Government – and ultimately you, the tax payer – who will pay the bill, if the bill gets paid at all.

This is an issue that we will be returning to over and over again in the coming years. Retiree obligations aren't going away...though those obligated to pay might be.