SNL Blogs

NASHVILLE NOTES

Thursday, January 03, 2013 7:58 AM ET

Chrysler's successful 1980 bailout may be prologue for banking's TARP experience

By Jeff K. Davis

Jeff Davis, CFA, is a veteran bank analyst and SNL contributor. The views and opinions expressed in this piece are those of the author and do not necessarily represent the views of SNL or Mercer Capital, where he is the managing director of the financial institutions group.

On Dec. 19, the U.S. Treasury announced that General Motors Corp. would repurchase 200 million shares held by the Treasury for $27.50 per share, which leaves Treasury with a 300 million common share position in GM that will be monetized through secondary offerings and maybe private placements over the next year or so. There has been much hand-wringing in Washington and the press that taxpayers will lose money on their GM investment given a break-even price of about $70 per share required for the remaining interest. Of course, the bailout was never intended to be a money-making investment; rather, it was intended to save the domestic auto industry and jobs.

Treasury invested about $53 billion in GM in late 2008 and during 2009 prior to its June 2009 bankruptcy filing. Including Ally Financial Inc. (previously General Motors Acceptance Corporation — GMAC) and Chrysler Corp., the total auto-sector investment was about $80 billion, of which about $50 billion has been repaid. For those of you who do not think government-directed credit decisions matter, I disagree. Housing, the key component in 2013 GDP hopes, is benefitting from Fed efforts to suppress mortgage rates. Auto sales were temporarily helped by the cash-for-clunkers program a few years ago; today they are helped by investors' search for yield in recovering ABS issuances and a general willingness to lend to marginal credits. It is no coincidence, I think, that GM's sales began to trend higher once subprime auto lender AmeriCredit was acquired by GM in late 2010. As such, the recent 14 million vehicle sales rate may ratchet toward 15 million this year, though that would remain below the pre-crisis peak of about 17 million units.

Treasury converted much of its debtor-in-possession financing into 50.2% (fully diluted) ownership of GM as part of the reorganization; Treasury's residual DIP loan and $2.1 billion of 9% preferred stock have since been redeemed. The balance of the "new" GM common owners upon exiting bankruptcy included Canada (9.6%), the United Auto Workers via its health care trust (16.9%; VEBA) and unsecured creditors via the legacy corporate entity (23.3%, inclusive of long-term warrants).

GM's IPO occurred in November 2010, when Treasury, VEBA and Canada sold about 550 million shares for $33.00 per share. (Underwriters agreed to the thinnest IPO fee ever, 0.75%.) The shares have traded lower ever since, perhaps reflecting the market's concern about the overhang from a large seller, an economy that has experienced subdued GDP growth since then, and the fact that the auto business is a highly cyclical, relatively low multiple business when based upon EBITDA through an entire business cycle.

GM (or Ally) will be the largest TARP-related loss, eclipsing the $2.3 billion Treasury lost in the orderly pre-packaged bankruptcy of CIT Group Inc. in late 2009. Ironically, American International Group Inc., whose financial casino operations that occurred at the parent company, repaid Treasury and Federal Reserve loans, while a combination of share repurchases and secondary offerings by Treasury allowed the government to net nearly $23 billion on $182 billion of AIG investments and loans. Should one infer that GM was a bad investment and AIG was a good investment?

For the most part, the press writes about the necessity of a government bailout of GM to preserve jobs and save an iconic domestic industry. A few will note, probably correctly, that debtor-in-possession (DIP) financing of the amount GM needed was available only from the Treasury, though I wonder why the administration could not have ordered its TARP banks to provide needed DIP funding. The banks were willing to underwrite GM's IPO for just 0.75%, most likely with the government leaning on the fee. Others will argue that the UAW obtained preferential treatment vis-à-vis bondholders.

As of Nov. 30, Treasury had received $267 billion for $245 billion invested in the bank portion of TARP. The bank lobby has worked hard to let the taxpayers know that the banks were a profitable investment, while the auto industry (and Ally Financial) should be viewed separately.

The view is factually true, but the thought process is wrong, in my view. Bad precedent was set in another era, when the Penn Central railroad declared bankruptcy in 1970, which was the largest at the time. From the ashes, Congress created Amtrak in 1971 to provide passenger service. Congress later authorized the nationalization of Penn Central, which still provided freight service under bankruptcy protection. The successor entity was Conrail, which remained a government controlled entity until 1987, when the Reagan Administration executed an IPO.

There are other instances of government involvement to prop up failing entities in the 1970s. Perhaps the most celebrated was $1.5 billion of loan guarantees that Congress approved and the Carter administration signed into law during 1980. The rescue of Chrysler, a perennial also-ran in the American auto industry, is celebrated because Chrysler, under the leadership of the charismatic Lee Iacocca, led a turnaround that resulted in the loans being repaid several years ahead of schedule. The Federal government probably also was helped by lending near the bottom of a severe double-dip recession, while falling oil prices a few years later sped Detroit's recovery.

So, nearly 30 years later, GM, GMAC (Ally Financial) and Chrysler receive another bailout. Unlike the 1980 loan guarantees that did not entail Chrysler entering bankruptcy to jettison debt and renegotiate union contracts, GM and Chrysler did so this time. Still, Treasury is going to lose its shirt on the investments. Does it matter? Maybe not given the purpose was to "save" an industry and its jobs rather than make money, as happened with the bank and AIG investments.

Chrysler and its unions were politically well-connected in 1979 when they convinced Washington to give the company a lifeline that lenders and investors would not. Iacocca's management and design teams apparently performed brilliantly. The result is that Chrysler lived when it should have died, or at least been forced into bankruptcy to reorganize or see its assets sold to other operators. So who was hurt in this? GM and Ford Motor Co. were, in my view. Washington's decision resulted in a weaker GM and Ford than would otherwise had been the case had their weakest competitor been allowed to fail. If GM and Ford would have been stronger, then so too would have been the UAW. There is no way to know for sure, but I suspect I am not too far off base.

I am sympathetic with the position former Treasury Secretary Henry Paulson, Federal Reserve Chairman Ben Bernanke and New York Federal Reserve Bank President Timothy Geithner faced in 2008. The capital markets were largely closed to U.S. depositories, though ironically Lehman led a large preferred offering for Fannie Mae in August 2008. Battlefield decisions had to be made, but I think that the stronger banks in the industry are going to regret TARP perhaps more so than Richard Kovacevich of Wells Fargo vocalized at the time.

By propping up failures — most notably Citigroup Inc. and some regional banks that were heavily exposed to CRE — with TARP, expanded deposit insurance, asset purchases and a zero interest rate policy that may continue for years, strong banks are weaker today than they otherwise would be. Further, government involvement is significantly greater. It is so great that I think it is a legitimate question for investors to ask if banks will be allowed to make much money when the government backstops deposit funding, provides capital in a pinch, while a large percentage of the assets consist of agency MBS, SBA loans and other government-backed assets.

TARP for the banks and capital markets has been a financial success. Perhaps there was no alternative for the government if the system was going to implode, but I wonder if the program will not prove to be comparable to the successful government lending to Chrysler a generation ago. It may prove to be a Pyrrhic victory, $23 billion of bank profits for Treasury notwithstanding.

Published with permission.
Jeff K. Davis, Managing Director of Mercer Capital's Financial Institutions Group, is a regular contributor to SNL Financial. He can be reached at jeffdavis@mercercapital.com or 615.345.0350.