This 3DAdvisors Report Covers:	
	Insider Trading: Insider Trading Behavior
✓	**Accounting**: Quality of Earnings Issues
✓	**Governance:** Corporate Governance Issues

Disclosure Behavior on Pension Issues Concern Us General Motors Corporation (NYSE:GM)

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General Motors Corporation provides automotive-related products and services by primarily designing, manufacturing and marketing vehicles, as well as providing communications services and financial services. The company operates in two segments, Automotive, Communications Services and Other Operations, and Financing and Insurance Operations.

Summary of 3DAdvisors Findings for GM

- **Governance:** Disclosure behavior as important to us as the numbers
- **Accounting:** Pension-related cash flow risks
- **Accounting:** Another issue exacerbating cash flow problems

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Discussion of 3DAdvisors Findings

Governance: Disclosure behavior as important to us as the numbers

We recognize that GM's pension liability, not to mention their accounting practices and policies in general, have received a tremendous amount of scrutiny in the past year and many of the issues that have been raised by other analysts are priced into the stock at the moment. While the accounting specifics are obviously important, our attention is drawn by GM's accounting and disclosure *behaviors*, rather than by the numbers alone, and some of the behaviors we have observed have left us with the feeling that the entire story on GM has yet to be told.

Our interest begins with a curious presentation that GM gave to analysts and the media in August of 2002 concerning its pension situation. Though the presentation was made in late August, it used Y/E 2001 numbers, which masked the significant deterioration that had occurred during the interim time period. There were plenty of other anomalies in the presentation:

At Y/E 2001, the under funded status of the funds was about $9.1 billion. The GM presentation assumed a tolerance of just 25 basis points around its current discount rate assumption of 7.30%. We already know that discount rate assumptions are coming down this year. A rate of 6.75%, which we are seeing more of, would be well outside of the company's indicated tolerance range for the presentation and would have significantly altered the outcome of the report. We already know that there is plenty of pressure to reduce these discount rate assumptions as well as Expected Rates of Returns, and GM currently uses a very high 10% rate. These assumptions already seem to have been proven faulty as GM has subsequently disclosed that its under funded pension situation could be as high as $21 to $23 billion by Y/E '02. S&P estimates that it could go as high as $28 billion.

As mentioned above, we recognize that the pension situation is rather well followed. There are, however, some points of magnitude, with regards to GM's pension exposure, that bear continued observation:

Pension-Related Balance-Sheet Risks

- At the end of '01, GM had off-balance sheet pension liabilities totaling $75.5 billion. The entire PBO (Projected Benefit Obligation) at that time stood at $86 billion. Even at Y/E 2001 (before factoring further deterioration in 2002) GM's huge Benefit Obligation would exceed the Company's entire market cap by 4.6 times.

- Of the entire $86 billion in Benefit Obligation (as of Y/E 2001), only $10.7 is carried on GM's books as a liability. To compensate for this, FASB requires the Company to record a portion of the Off Balance Sheet Obligation as a charge to equity in the form of a Minimum Pension Liability. In spite of the fact that FASB rules allow for considerable smoothing in the calculation of this liability, GM's charge to Shareholders Equity is estimated (by Credit Suisse/First Boston) to be as high as $10.9 billion by Y/E '02, or 55% of shareholders equity.

<u>Accounting: Pension-related cash flow risks</u>

In the August 2002 presentation, GM said that, under ERISA Minimum Funding rules, no additional contributions over the $3.2 billion infusion to its Pension Funds in ‘02 would be required "until late 2006". Through July, the Company had committed $2.2 billion in the form of Fund Contributions and another $1 billion to its long-term Voluntary Employees' Beneficiary Association (VEGA) Trust. We find it “interesting” that in the two months following this presentation, GM had moved that timeline in: In an October disclosure, a GM spokesperson said that the company is not required to make an additional contribution to the plan until at least '04, two years earlier than the Company's August assumption.

The August GM presentation attempted to draw a picture of what required future contributions would look like, given certain assumptions of Actual Returns on Plan Assets. To us, the assumptions raised a number of questions:

- The first assumption was a 0% Return on Assets for '02 (as of the Q3 release, the fund performance was about -10%), and 10% annually (the current Expected Rate of Return) for the years '03 through '06. Under this scenario, the present value of required Contributions necessary to avoid PBGC Variable Premium Charges was $6 billion.

- The second assumption was a 0% Return on Assets for '02, and 8% annually for the years '03 through '06. Under this scenario, the present value of required contributions, in order to avoid the PBGC charges, would be $9 billion.

- The third scenario assumed a -5% return for '02, and 8% annually for the years '03 through '06. This scenario would result in contributions totaling $12 billion.

Clearly, the use of the above assumptions, along with Y/E '01 numbers which focused on the $9.1 billion under funded status which existed at that time, the Company was attempting to ease concerns that it would be required to make additional contributions to the funds in the near-term. Subsequent Company disclosures indicating an under funded position in the $21 to $23 billion range have not only impugned the credibility of earlier Company forecasts but also heightened the probability of accelerated significant fund contributions in the not-too distant future. Credit Suisse/First Boston estimates a likely contribution of $5 billion to be made in '03.

These assumptions, of course, translate directly to future EPS risks. We already know that an Expected Rate of Return of 10% is too high by today's standards. Even at year-end '01, the Company's Actual Returns on Plan Assets of a loss of $4.83 billion fell $12.96 billion short of the Expected Return of a gain of $8.13 billion. The gap is mind-boggling: if the Company had been required to use Actual Returns in its periodic cost calculations, the Pension costs for the '01 period would have wiped out the total of all recorded pre-tax net income for the years '98 through '00.

Certainly, GM is not required to use actual Returns on Assets in the calculation of its Benefit Costs. The above argument, however, helps illustrate the magnitude of a problem, which has only become worse in '02. In its Sensitivity Analysis on The Impact on Pre-Tax Pension Expense, GM's behavior again seems to suggest they are ignoring the problem. The August presentation assumes a variability of just 1% in Expected return (potential charge of $700 million), Discount rate variability of 25 basis points (hit of an additional $125 million), and actual '02 Asset Returns variability of - 5% (another $375 million hit). Perhaps we should consider this $1.2 billion case (the total of the above items) the Company's best-case scenario even before accounting for the effects of further deterioration that took hold in the second half.

Clearly, S&P has taken the lead, over other agencies, in factoring in the effect of under funded pension funds into the Cash Flow, Earnings and Balance Sheet analysis in their rating of GM's debt. S&P now rates GM's Debt at BBB. What you may not know is that at least one of the Company's Trade Payables Agreements (with GE Capital Corp.) apparently became altered when GM's unsecured debt obligations dropped to BBB by S&P. In this case the event of the ratings reduction would accelerate, by 40 days, GM's payment terms, to GECC, with regards to receivables GECC has purchased or paid on behalf of GM. The risk, to this facility, becomes fatal should there be further ratings reductions: If either S&P or Moody's ratings drop lower (BBB minus with a negative outlook for S&P; Baa3 with a negative outlook for Moody's), the entire $2 billion financing program becomes unavailable to GM and its suppliers.

Accounting: Another potential issue exacerbating cash flow problems

Another issue that has been downplayed is that GM is facing trouble in with its Fiat investment (GM owns 20%). It turns out that Fiat has a put option, which requires GM to buy the remaining 80% of Fiat. The Put option is exercisable beginning January '04. This is not good as things are not going well at Fiat. In Q3, GM has disclosed that it will write down the value of its $2.4 billion investment in Fiat by $2.2 billion.