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HEARD ON THE STREET

UAW Deal Turns Headlights on GM's Planning

Top U.S. automaker will need to reassure investors that cost-savings targets and downturn preparation are on track

By Stephen Wilmot

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For now, General Motors can afford its generous deal with the United Auto Workers Union just fine. The bigger question is what happens when sales slide. Chief Executive Mary Barra has some reassuring to do when the largest U.S. auto maker reports third-quarter results later in October.

Late Thursday, the UAW published details of the deal it has sent to its members for approval. It includes some important wins for the union, particularly on behalf of more recent hires, who will reach the top wage twice as quickly as before, and staff on temporary contracts, who have a faster route to getting permanent ones. There are also 3% wage increases in two of the four years covered by the agreement, with 4% bonuses in the other two. Most staff will get an $11,000 signing bonus.

Has GM given up its prized flexibility to get staff back to work? Joseph Spak at brokerage RBC expects the wage deal to add roughly $100 million to GM's annual costs, with an additional $485 million hit from the signing bonus spread over four years. The stock has dropped roughly 7% since the strike started in mid-September.

Without knowing what wage inflation the auto maker factored into its planning, though, investors have no sure way of modeling the deal's impact on future profits. These will depend in part on the $4.5 billion cost-savings target GM announced in November. Importantly, the deal still allows the company to close three of the four plants it moved to "unallocate" at that time, and the fourth plant will get an electric pickup truck that it needed to build anyway.

The company's own guidance will be key. Any updated cost-savings target—rather than the one-time cost of the continuing strike itself, estimated by some analysts at more than $2 billion—will be the most important number to watch in GM's results.

Whatever the impact, it isn't going to hurt GM much right now. In previous eras, investors rightly worried that expensive union packages made U.S. auto makers uncompetitive relative to nonunionized Japanese and European peers. Now, though, GM mainly competes with its unionized Detroit peers in the segments that matter most to profits: U.S. pickup trucks and sport-utility vehicles. Given that its deal with the UAW will be a template for similar deals at Ford and Chrysler, it is pushing up costs for its key rivals too. And for now, U.S. consumers seem happy to pay more for their wheels, helped by generous financing terms.

The real worry is what happens when the sales environment sours. Given its history of bankruptcy, GM hasn't been shy about scenario planning. Chief Financial Officer Dhivya Suryadevara said at a JPMorgan conference in August that a 25% decline in U.S. car sales—what she called a "moderate downturn"—would hit GM's operating profits by 60% to 70%, including a shift in demand in favor of cheaper, less-profitable vehicles. Free cash flow would break even, excluding a likely $5 billion unwinding of working capital that would have to be funded from the company's $18 billion cash pile.

How will these numbers be affected by the UAW deal? The agreement didn't contain strong assurances for workers on job security, which may help mitigate the impact. If GM can make a convincing case that its cost targets and downturn planning are robust, even after the UAW deal, investors will conclude that it got off lightly.

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