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GM Expects to Continue Burning Cash in '07

By JOHN D. STOLL

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General Motors Corp. expects its cash flow to remain negative this year even though it has taken out billions of dollars in fixed costs and is hitting the peak of its product cycle.

Frederick Henderson

At a conference for analysts, Chief Financial Officer Frederick "Fritz" Henderson said GM's cash flow would be improved compared with 2006, but he acknowledged the company would again burn cash for another year, in part because of increased capital spending. GM's cash flow, he said, is "not anywhere near an adequate position."

The forecast of negative cash flow means the big auto maker will continue to face serious financial pressures for at least an additional 12 months as it works to turn around its unprofitable North American auto operations. GM faces declining market share and intensifying competition, as well as high costs.

Nevertheless, GM executives said the company's turnaround is moving forward. "We plan to make another significant step on these business metrics in 2007," Chief Executive Rick Wagoner told analysts during his presentation.

Mr. Henderson declined to forecast a precise figure for cash flow in 2007. He said GM expects earnings to improve in 2007 but didn't offer a more detailed outlook. GM stopped giving earnings guidance in 2005 when it began racking up big quarterly losses.

In an interview earlier this week, he said GM will give more guidance on future cash flow sometime later this year. The auto maker may sell some assets throughout the year to further pad liquidity, Mr. Henderson added.

For the first three quarters of 2006, GM reported a net loss of

$3 billion and a cash outflow of $4.2 billion.

In statements and slides for the conference, GM said total revenue will increase because of strength in emerging markets such as China and Russia, and key vehicle launches in the U.S. The company has just launched a redesigned Chevrolet Silverado pickup, its top-selling vehicle, and has several other highly anticipated vehicles coming in 2007. These include three new seven-passenger "crossovers" and a new Chevy Malibu sedan.

Richard Wagoner Jr

One reason for the negative cash flow is that GM plans to increase its world-wide capital spending to a range of $8.5 billion to $9 billion in both 2007 and 2008, versus less than $8 billion in both 2005 and 2006, as it redoubles its commitment to product development. The auto maker fell short of the $8.7 billion in capital expenditures it expected in 2006.

Mr. Henderson said the capital-expenditure increase is evidence the company wants to keep funding new products even after it floods its lineup with updated cars and trucks in 2007. "We're not backing off, we're going to step on the gas," he said.

GM is counting on the new models to enable it to edge prices a bit higher and reduce the need for rebates and other sales incentives, which eat into its profit margins. It also again plans to reduce sales to rental-car companies, a practice that over the long run lowers the resale value of its cars and trucks.

Mr. Henderson said GM expects industry-wide vehicle sales to be flat in North America in 2007, with weakness in the first half of the year being offset by a stronger second half.

The company said it is keeping a close eye on raw material costs and will work to offset the rising cost of steel and other commodities by implementing cost cuts.

It also plans to address high health-care and retiree-related costs in 2007, with particular emphasis on the company's negotiations with the United Auto Workers, which start in July ahead of the current contract's expiration in September.

GM North America Chief Troy Clarke said the company doesn't plan to see significant financial savings from the deal in 2007 because negotiations take place late in the year. After the new pact is negotiated, UAW members must ratify the agreement, and a court will likely need to approve it.

In 2006, GM shed 34,000 union workers from its payroll, part of a savings effort that is supposed to lower fixed costs by $9 billion in 2007. Those job cuts, Mr. Clarke said, leave GM North America "positioned for success."

---- Neal E. Boudette and Stephen Wisnefski contributed to this article.

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QUESTIONS:

1.) What is negative cash flow and how could it be managed?

2.) Based on only comments provided in the article, state whether you believe each section of General Motors cash flow statement will show a positive or a negative amount for 2006 and 2007 (forecasted). Support your answer.

3.) What are the amounts of net income/loss and cash flows from operating activities for GM in the first nine months of 2006? What causes the difference between these two amounts?

4.) What typically generates a negative cash flow from operating activities? How is GM trying to stop this from happening? Cite specifics from the article.

5.) Define the terms fixed costs and variable costs. GM is focusing on reducing fixed costs; cite examples of fixed costs that GM is trying to control. Why is that effort crucial to generate positive cash flows?

6.) GM also is trying to control certain variable costs. List the specific variable costs mentioned in the article.