The original documents are located in Box B13, folder "Chrysler Corporation" of the Arthur F. Burns Papers at the Gerald R. Ford Presidential Library.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 22, 1974

To Chairman Burns

Subject: Economic Position of Chrysler

From Capital Markets Section
(Mr. Puckett)

This memorandum examines the present condition of Chrysler Corporation, its vulnerability to failure, and possible implications should failure occur.

Over-all, it would appear that Chrysler today is in a financial condition somewhat analogous to that in late 1969 and 1970. The substantive difference between the situation then and now seems to be that industry automobile sales in the first half of 1975 may be lower than in any period in 12 years, if the staff's projections of domestic auto sales materialize. Therefore, Chrysler's financial difficulties are likely to deepen.

Whether or not the Company fails, severe effects on stockholders, employees, and suppliers will continue to be felt by the plunge in Chrysler stock prices, layoffs, and cutbacks in production. If the firm should fail, the "shock" effect would at least be cushioned by the previous widespread recognition of its financial troubles.

<u>Sales and Inventory Position</u>

Chrysler is working in an unfavorable environment--one in which automobile sales have plunged in recent months and dealer stocks have soared. (Charts 1 and 2) Third quarter auto sales were at a seasonally adjusted annual rate of 8.5 million units, and sales in the fourth quarter as projected in the most recent Greenbook are expected to be 6.8 million units (SAAR)--the lowest since the fourth quarter of 1970, when there was a long strike at General Motors. But there are indications even that low rate may be revised downward in the light of the weakening over-all economic picture and indications of a continued decline in auto sales. Data for October show sales of 6.4 million units, while data for the first 10 days of November indicate sales of only 5.5 million units (SAAR).

In this environment, Chrysler's relative position also has deteriorated as its share of the passenger car market has fallen by about four percentage points since the first of the year. In part, this may be viewed as a return to a somewhat more normal situation since Chrysler's position around the beginning of the year was unusually strong. Nonetheless, the erosion of its market share plus a general deterioration in over-all industry sales has resulted in significant difficulties for Chrysler, which have been exacerbated by its reluctance to cut output sufficiently to match the reduced level of consumer demand. As of the end of October, Chrysler was holding a 108 day supply of cars in inventory (not seasonally adjusted), given its rate of sales for October, versus a 62 day supply for the rest of the industry, excluding Chrysler. Chrysler's inventories, moreover, contained inordinately large amounts of 1974 models. Recently, Chrysler has responded to this large build-up in stocks by shutting down all but one of its six domestic assembly plants and announcing plans for laying off nearly 44,000 workers, which will bring the total layoffs to 70,500 in December--a significant portion of the nearly 154,000 workers it employed on average during 1973. Reports, in addition, have been published of plans for even more layoffs, but as yet without official confirmation from the Company.

Chrysler's Financial Position

All of these difficulties are compounded by the fact that Chrysler, as is well known, is one of the weakest firms in the industry. This is amply borne out by Table 1, showing data as of mid-year, when detailed information was last available. Perhaps the most surprising thing about the data, however, is the degree of Chrysler's weakness relative to other firms in the industry, including American Motors. Chrysler's leverage, as measured by its debt-equity ratio is substantially higher than any other firm, as is its ratio of short-term to long-term debt. Not surprisingly, its coverage of interest and fixed charges is also very thin.

Indicative of Chrysler's slow sales, large inventories, and high fixed charges is its performance for the first nine months of the year, showing an after-tax profit of only $21 million--the smallest since 1970. (Table 2) Further evidence of Chrysler's weakening position is its after-tax loss of $8 million in the third quarter, versus small profits in the first two quarters of the year. (Tables 3 and 4) Though this 1974 third quarter performance was better than that for the third quarter of 1973, in the sense that losses were smaller, 1973 results were plagued by parts shortages and strikes.

As for the balance sheet, information as of September 30, indicates the current ratio (current assets/current liabilities) is the lowest for any third quarter since 1969, despite the swollen inventories of the Corporation. (Table 5) The quick ratio (current assets excluding inventories/current liabilities) is essentially the same as in 1973 and is only a modest amount above that for 1970. But the liquidity position of the firm has been weakened by payment of dividends that were not earned--$57 million paid versus only $21 million earned after taxes in the nine months ending September 30, and in the third quarter, $19 million paid versus a loss of $8 million after taxes.

This payment of dividends in excess of earnings was one of the reasons cited by Moody's in its recent downgrading (from P-1 to P-2) of the commercial paper of Chrysler's financing subsidiary, Chrysler Financial.[1] Other reasons cited were Chrysler Corporation's poor performance, primarily with respect to profits, and also the erosion of Chrysler's working capital position throughout the year.

The downgrading of Chrysler Financial's commercial paper and the information circulating about the condition of Chrysler has made it difficult for the financing subsidiary to sell its paper, except in very short maturities. (Table 6) Since October 31 the outstanding commercial paper of Chrysler Financial has fallen by $220 million, which is being replaced by bank loans. Adequate bank credit probably is available to Chrysler Financial since at the end of October, back-up lines of credit approximately matched outstanding commercial paper. Thus, the main effects of the shift from commercial paper to bank credit, besides foreclosing an alternative source of finance, seem to be a significant increase in the cost of funds. Sources at Chrysler Financial estimate that at recent rates the Company would have to replace commercial paper at 9-3/4 per cent with bank loans at 10-1/2 to 11-1/2 per cent, plus 10 per cent compensating balances.[2] As a result, a significant conversion of commercial paper to bank credit could appreciably

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1/ Standard and Poor's, for quite some time, has rated the commercial paper as of medium quality (A-2).

2/ Apparently, no balances have been required to support unused lines of credit.

lower Chrysler Financial's net income and hence further weaken the position of the parent corporation.

Over-all the position of Chrysler seems then to be some cause for concern. In some ways, its situation today is analogous to that in late 1969 and on into early 1970 when it had a narrow margin of liquidity and poor profits. Gradually, after the first quarter of 1970 the company recovered until it, along with the rest of the industry, was adversely affected by the Arab oil embargo last year.

However, there are important differences between the situation today and that in late 1969 and early 1970. Industry auto sales subsequent to and during Chrysler's earlier financial weakness never dipped below 7.5 million units (SAAR), except during the interval covered by the General Motors strike. Yet if the Greenbook projections concerning domestic auto sales materialize, industry sales will be at a rate of 7.0 million units during the first half of 1975--the lowest rate in twelve years. Some recovery is expected in the second half of the year to around 7.5 million units. But, in the light of recent events, these projections, both for the first and second half, may be revised downward. Therefore, Chrysler may be facing a significantly more austere marketing picture than in the periods when it was previously in financial difficulties, while probably being burdened with a higher break-even point.

Some Implications of a Chrysler Failure

If Chrysler were to fail the resulting "shock" effects would be cushioned by the fact that its financial problems have been well-publicized. News of its plant closings, sluggish sales, large inventories, weak profits, and inadequate liquidity are widely known.

Partly as a result of such adverse information, Chrysler stock on November 20 closed at $8.75, down from a high for the year of $20.12. The Company's bond ratings are already relatively low (Standard and Poor's and Moody's A), and the recent Moody's downgrading of Chrysler Financial's commercial paper only ratified adverse news about the parent company.

Purchasers of commercial paper, already sensitive to the position of Chrysler Financial, have, as noted previously, been reluctant to continue to lend except on a very short-term basis. Bank loans to Chrysler Financial secured by the Company's receivables have increased as a replacement for commercial paper run-offs. Such loans totaled $638 million as of November 12. The total amount of bank debt owed by Chrysler and its subsidiaries, however, is not known.

Chart I

Domestic New Car Sales
(monthly, seasonally adjusted)

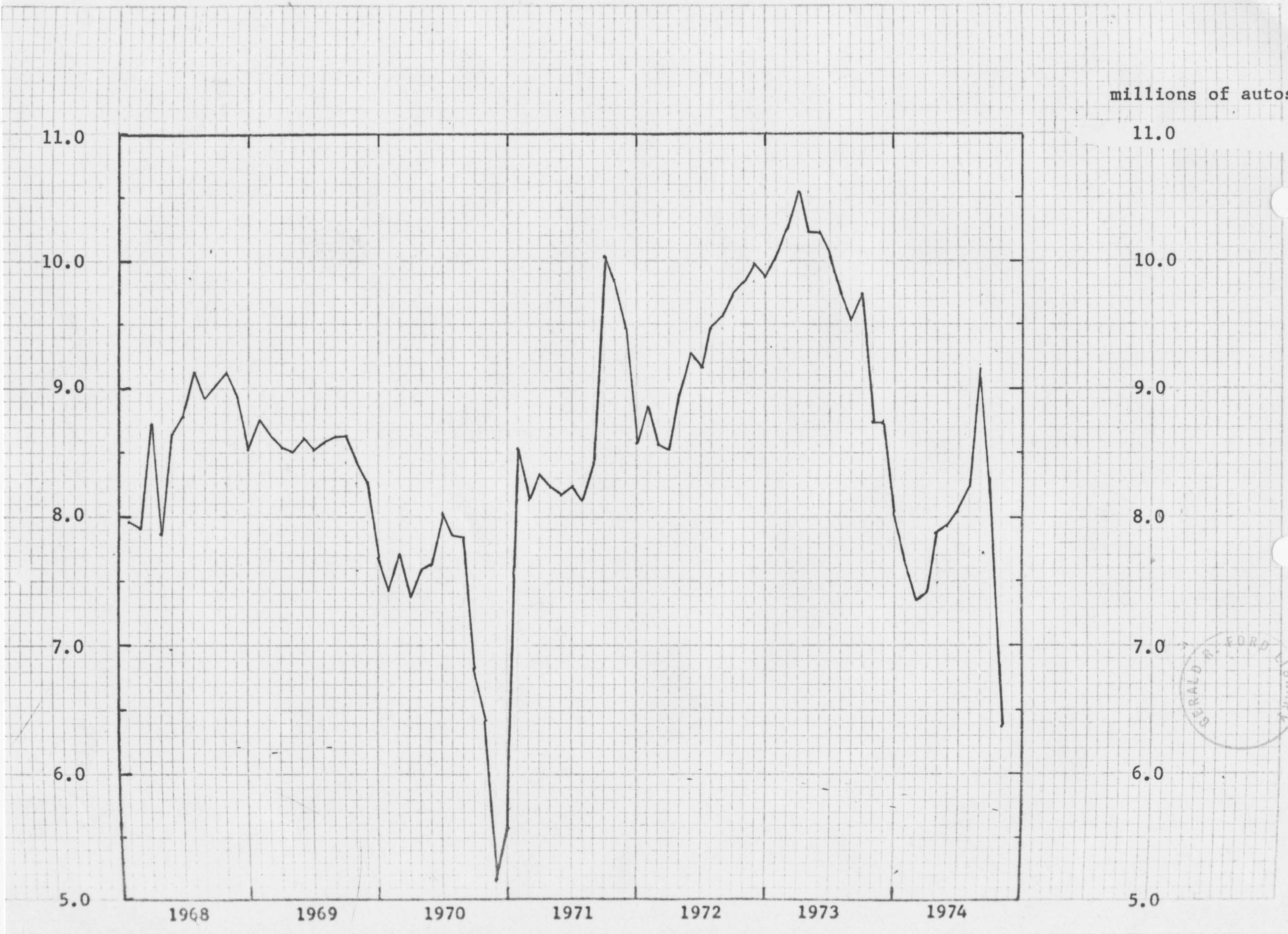

Chart 2

Dealers' Inventories
Domestic New Car Stocks

(monthly, seasonally adjusted)

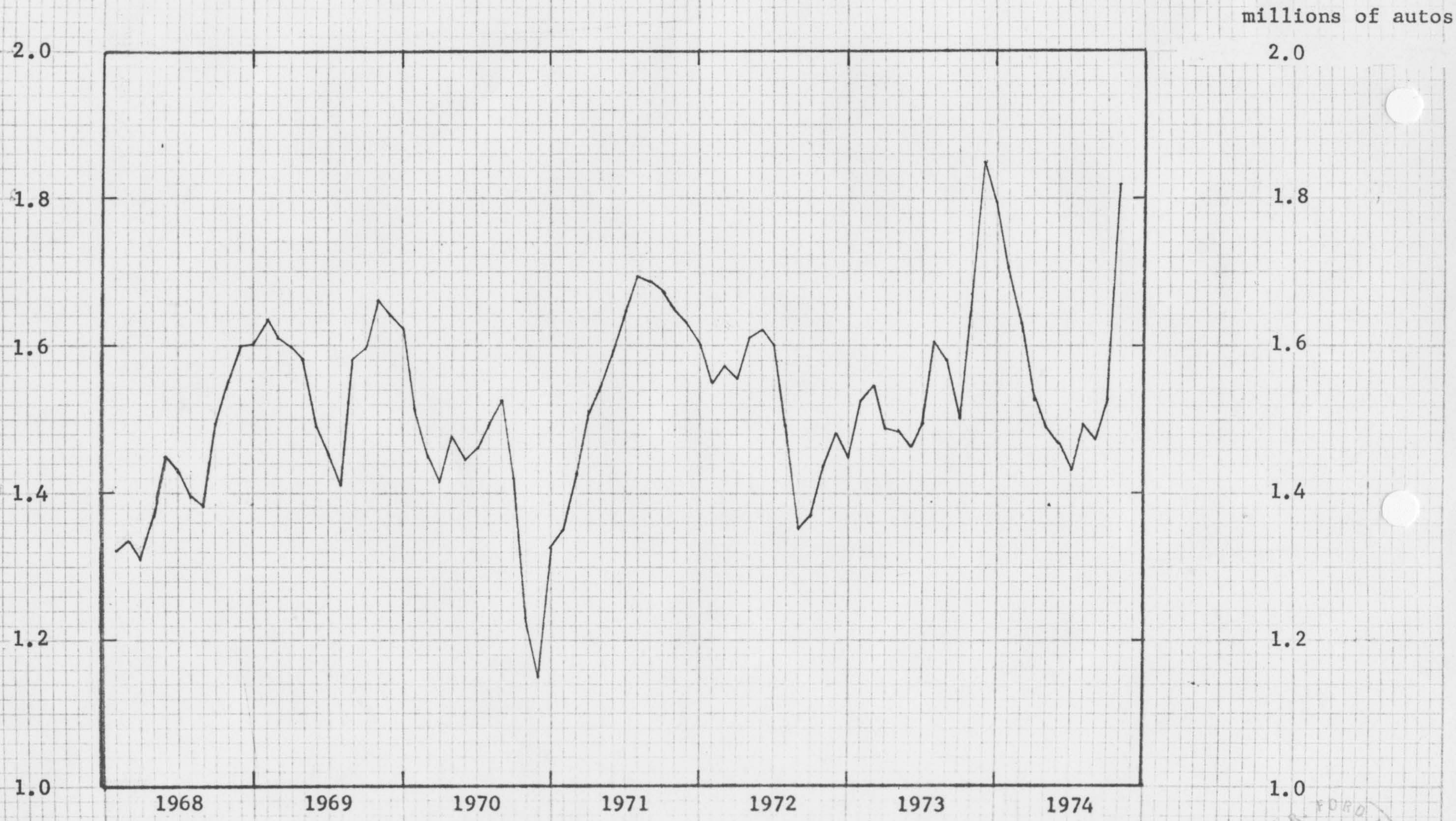

Table 1

Selected Balance Sheet Ratios for Major Motor Manufacturers
($ millions)

		Chrysler	General Motors	Ford	American Motors
Total debt ($ millions)	6/30/74	1,426	1,192	1,915	80
Debt as per cent of equity	6/30/74	52	10	30	20
Avg. debt as per cent of equity	1964-73	38	7	18	28
Short-term as per cent total debt	6/30/74	42.4	36.5	36.7	0
Avg. short-term as per cent total debt	1964-73	29.9	40.2	49.5	54.0
Coverage ratios:					
Interest cover. ratio pretax	6/30/74	3.1 1/	44.0	10.3 2/	10.4
Total fixed charge cover. ratio	6/30/74	3.0 1/	35.7	10.1 2/	10.4

1/ Interest expense reported net of interest income by company in some periods.
2/ As of December 31, 1973.

Definitions:

Total debt----------------Long-term plus short-term debt.
Debt as per cent of equity--Total long- and short-term debt as a per cent of common equity, which includes common stock, capital surplus, retained earnings.
Interest coverage ratio-----Pretax income plus total interest expense divided by total interest expense.
Total fixed charge coverage ratio----------Net income plus total interest expense (adjusted by tax rate) divided by fixed charges (adjusted by tax rate) plus preferred dividends paid.

Source: Business Week: October 12, 1974.

Table 2

Chrysler Corporation and Consolidated Subsidiaries
Income Statement for Nine Months Ending September 30
($ millions)

	1968	1969	1970	1971	1972	1973	1974
Income:							
Net sales	5,298	5,240	5,147	5,855	7,054	8,364	8,506
Equity earnings	10	5	-7	2	10	9	8
Other income	26	19	-9	5	8	11	-1
Total income	5,334	5,264	5,131	5,862	7,073	8,384	8,514
Expenses:							
Costs	4,579	4,692	4,786	5,330	6,346	7,592	7,961
Depreciation	122	129	135	132	132	137	145
Amortization	129	147	128	130	145	139	107
Pension plans	100	85	88	124	137	152	199
Incentive comp.	14	1	--	--	9	12	--
Interest expense net	19	23	34	54	45	19	68
Total expenses	4,963	5,077	5,171	5,770	6,814	8,051	8,480
Profits before taxes	371	187	-40	92	259	333	34
Income taxes	196	94	-21	41	122	150	11
Minority interest	-2	-1	-5	3	2	2	1
Net income	179	93	-15	48	136	181	21

Note: Details may not add to totals due to rounding.
Data for 1968-1970 may not be strictly comparable to current classifications.

Table 3

Chrysler Corporation and Consolidated Subsidiaries
Income Statement for Quarter Ending September 30
($ millions)

	1968	1969	1970	1971	1972	1973	1974
Income:							
Net sales	1,561	1,560	1,687	1,893	2,314	2,309	2,801
Equity earnings	4	1	3	3	7	5	8
Other income	8	6	-4	2	0	3	-10
Total income	1,573	1,567	1,686	1,898	2,321	2,317	2,799
Expenses:							
Costs	1,401	1,447	1,564	1,743	2,107	2,219	2,643
Depreciation	42	41	44	45	44	45	48
Amortization	37	42	35	38	47	36	27
Pension plans	27	24	27	42	45	52	64
Incentive comp.	--	-3	--	--	2	-3	--
Interest expense net	7	8	12	17	13	7	28
Total expenses	1,513	1,560	1,682	1,885	2,258	2,356	2,810
Profits before taxes	60	7	4	13	63	-39	-11
Income taxes	33	2	1	5	30	-21	-3
Minority interest	-2	0	0	1	1	0	0
Net income	30	4	2	6	32	-17	-8

Note: Details may not add to totals due to rounding.
Data for 1968-1970 may not be strictly comparable to current classifications.

Table 4

Chrysler Corp. and Consolidated Subsidiaries
Net Income After Taxes
($ millions)

	1968	1969	1970	1971	1972	1973	1974
QI	64	48	-27	11	36	90	2
QII	85	41	10	31	68	109	28
QIII	30	4	2	6	32	-17	-8
QIV	111	-4	7	36	84	73	--
Year	290	89	-8	84	220	255	--

Note: Data for 1968-70 may not be strictly comparable to current classifications.

Table 5

Chrysler Corp. Consolidated Balance Sheet
Amounts Outstanding September 30
($ millions)

	1968	1969	1970	1971	1972	1973	1974
Assets:							
Cash & marketable securities	471	376	220	345	639	327	366
Inventories	936	1,122	*1,298	1,339	1,365	1,753	2,058
Other current assets	684	811	607	610	675	822	1,110
Total current assets	2,091	2,310	*2,125	2,294	2,680	2,901	3,534
Other assets	2,185	2,403	2,626	2,603	2,521	2,739	2,954
Total assets	4,277	4,713	*4,751	4,897	5,200	5,640	6,488
Liabilities:							
Current liabilities	1,413	1,671	1,509	1,605	1,757	*1,973	2,553
Stockholders' equity & long-term debt	2,864	3,041	3,242	3,292	3,443	3,667	3,935
Total liabilities	4,277	4,713	4,751	4,897	5,200	5,640	6,488
Net working capital	679	638	*616	689	923	*928	981
Current ratio	1.481	1.382	1.408	1.430	1.525	1.471	1.384
Quick ratio	.817	.710	.548	.595	.748	.582	.578
Sales/Inventory	5.658	4.669	3.964	4.380	5.168	4.772	4.133
Memo:							
Sales (9 months ending September 30)	5,298	5,240	5,147	5,855	7,054	8,364	8,506

* Restated figures
Note: Detail may not add to total due to rounding.

Table 6

Chrysler Financial Corporation - End of Month
($ millions)

	Commercial Paper		Bank Loans	
	Outst.	Change	Outst.	Change
1973-Sept.	937	-21	--	--
Oct.	1,025	88	--	--
Nov.	1,072	47	--	--
Dec.	1,184	112	--	--
1974-Jan.	1,155	-29	--	--
Feb.	1,177	22	--	--
Mar.	1,277	100	--	--
April	1,183	-94	100	100
May	1,250	67	102	2
June	1,218	-32	151	49
July	1,341	123	63	-88
Aug.	1,375	34	6	-57
Sept.	1,312	-63	206	200
Oct.	1,255	-57	381	175
Nov. 21	1,035	-220	638	257

Commercial Paper Maturity Schedule
($ millions)

	Paper Maturing	Paper Sold
1974-Nov. 18	155	95
19	90	90
20	123	90
21	103	67
22	104	--
25	64	--
26	13	--
27	36	--
29	60	--
Dec. 2	35	--
Amount through Dec. 2	783	--

BOARD OF GOVERNORS
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Office Correspondence

Date September 19, 1973

To Chairman Burns

Subject: Proposed Chrysler Settlement

From Murray Wernick MW

The proposed Chrysler contract, covering 117,000 production workers is expected to serve as a pattern contract with some possible minor modifications for about 550,000 other workers at GM and Ford. Both management and labor have indicated it is a liberal settlement and it appears to be above the Cost of Living Council guidelines. Chrysler estimates that it will increase labor costs about 7 per cent each year during the three year contract period. Since it has a cost of living clause this estimate would seemingly require relatively moderate price increase over the next three years to be achieved. Data made available on fringes are still rather limited and impossible to cost out. But they appear to be fairly extensive and close to unions original demands.

Wage rates will be increased by 3 per cent per year (productivity increase) with an extra first year supplement of 12 cents. Part of the first year supplement is an offset for normal cost of living adjustments that would have been made for the April 1973 to September 1973 period.

Cost-of-living adjustments continue with no ceiling and the basic formula was liberalized somewhat--1 cent adjustments will now be given for each 0.35 per cent increase in the CPI each quarter. Under the old contract workers received 1 cent for each 0.4 per cent increase in the CPI. During the term of this contract the union has agreed that 1 cent of each quarterly adjustment (a potential total of 10 cents) is to be used to finance other fringe benefits.

<u>Voluntary overtime</u> was agreed to by the company after nine hours work per day, for Sundays and for Saturdays if the worker had worked the two previous Saturdays. This could lead to some increased costs in periods of high auto output.

<u>Pensions</u> will be increased significantly. Any worker with thirty years of service can retire, receiving $500 a month the first year with the total rising $50 in each of the next two years. Other details of the pension plan revisions have not been spelled out yet.

<u>Health</u> programs are to be expanded to include dental care in the second year of the program and the company has agreed to pay both employer and employee taxes provided in any national health insurance program that may become law during the contract period. Money now used by the company to pay health benefits would be distributed to the workers in a manner to be decided if the health insurance program is passed.

Paid holidays will be increased under the new contract with the day after Thanksgiving included as a paid holiday. Holiday schedules may be revised somewhat but these details were not available.