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Netflix on wheels

Evan Lorenz writes:

Tesla, Inc., the largest maker of battery-powered vehicles, is the employer of the world's richest man and the issuer of what is arguably America's foremost meme stock (TSLA on the Nasdaq). More than a business enterprise, Tesla is an avatar, of the fast-deflating everything bubble and of the unbuttoned, disinhibited times themselves. In preview, *Grant's* is bearish on it.

On paper, the company is divisible into two units only, but the conscientious analyst will not forget a third. No. 3 is the Tesla magic, which can be capitalized even if it can't be quantified. TSLA wears a $886.6 billion equity market price tag, commands a 100.7 times trailing price-earnings ratio and registers a de minimis short interest of 2.4%.

In fact, for Mr. Market's money, Tesla is worth more than a half-dozen non-Teslas. Together, General Motors Co., Ford Motor Co., Toyota Motor Corp., Volkswagen A.G., Mercedes-Benz Group A.G. and Bayerische Motoren Werke A.G. (BMW) command an equity market cap of just $504 billion and trade at an average of six times earnings. As to 12-month trailing revenues, the non-magical six logged $1.1 trillion compared with Tesla's $67.2 billion.

The Tesla magic radiates from the person of Elon Musk, the celebrity CEO, as much as from any Tesla product, achievement (as considerable as many of them have been), promise, timeline or strategic vision. The accomplished individuals who lead the non-Tesla six are by and large faceless. With 107.1 million Twitter followers, Musk is as recognizable as Kim Kardashian and as unpredictable as Kanye West.

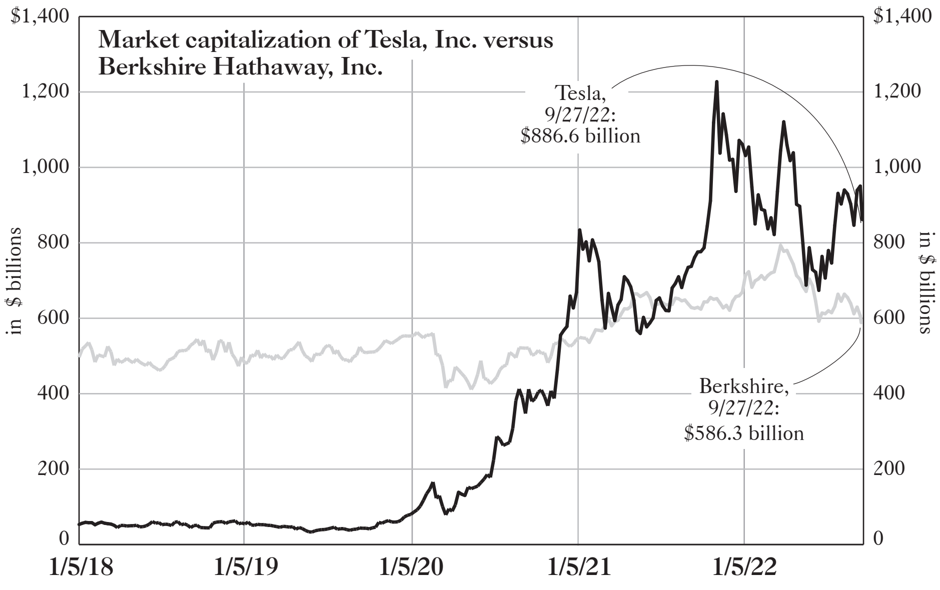
It's Musk who, astoundingly, earned $23.5 billion last year though Tesla reported net income of less than one-quarter of that sum. The GAAP-sanctioned conventions for the treatment of stock options explain this seeming non sequitur, but it's not so easy to account for Musk's exemption from ordinary social and regulatory norms.

"Funding secured" the CEO claimed in his false, "going private" tweet of 2018, for which the Securities and Exchange Commission did, in fact, fine him (though a footling $20 million) while barring him from unsupervised tweeting. Suffice it to say that Musk went right on tweeting, without in-house legal oversight, and the SEC has been unable to stop him.

A May 24 Reuters bulletin that ran out under the headline, "In a faceoff with Elon Musk, the SEC blinked," contains a sentence that neatly sums up the balance of power between the U.S. government and the noncompliant visionary: "Musk was and remains Tesla's largest shareholder, with roughly 16% of the stock as of late April, so it might be hard to argue that barring him as a public company director or officer was in shareholders' interests or would loosen his grip on Tesla."

In preparation for taking office in 2021, SEC Chairman Gary Gensler disclosed a personal investment in Tesla, one that he held for a full two years after

Elon vs. Warren



source: The Bloomberg

Tesla, Inc. at a glance
all figures in $ millions except per share data

	TTM*	2021	2020	2019	2018
revenue	$67,166	$53,823	$31,536	$24,578	$21,461
operating profit	10,684	6,523	1,994	-69	-388
net income	9,516	5,519	721	-862	-976
earnings per share	2.77	1.63	0.21	-0.32	-0.38
shares outstanding	3,465	3,387	3,249	2,655	2,558
cash	18,915	17,707	19,384	6,268	3,686
debt and leases	4,430	6,834	11,688	13,419	11,972
deposits & def. rev.	5,250	925	752	726	793
total assets	68,513	62,131	52,148	34,309	29,740

* For the 12 months ended June 30, 2022.

sources: company reports, the Bloomberg

the notorious Musk tweet. Interestingly, TSLA was the one and only individual equity position that Gensler identified in his pre-appointment vetting.

Today, duly ensconced in office and no longer a Tesla shareholder, the SEC chairman is reported to be leading a crackdown "on repeated misconduct." Perhaps he noticed that Musk was a late filer of the required documents pertaining to his April investment in Twitter.

Cocking a snook at the feds is one thing; provoking the furies of #MeToo is arguably riskier, yet here, too, Musk has dodged bullets. In 2018, he settled an allegation that he exposed himself to a SpaceX flight attendant (Musk at the time was her boss as CEO of the Space Exploration Technologies Corp.), and in 2021, he fathered twins with an employee of Neuralink Corp. (of which enterprise he is a co-founder and owner).

Writing one's own rules of conduct while building a great enterprise and reaping those heaps of billions marks Musk as a special being. Except for the massive U.S. government electric-vehicle subsidies he takes to the bank, his casual breaking of promises and his kowtows to the Chinese Communist Party, he could almost pass for an Ayn Rand hero.

Of course, there's magic in the electric vehicles themselves. Musk seized the opportunity in a product that, according to a June survey by Hedgeye Risk Management, no fewer than 83% of respondents expressed an interest in buying. And as Musk makes what people want to drive, so he tells them what they want to hear. "The very purpose of Tesla's existence," asserts the corporate 10-K report, "is to accelerate the world's transition to sustainable energy."

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What the Tesla automotive division makes is the Model S (a sedan first released in 2012), the Model X (a midsize sports utility vehicle, 2015), the Model 3 (sedan, 2016) and the Model Y (midsize SUV, 2019). In the 12 months ended June 30, it sold 1.1 million units worldwide, direct to consumer, generating $64.2 billion in sales and $18.2 billion in gross profits.

The energy and storage division, which designs, manufactures and installs solar panels and battery-storage systems, has deployed 322 megawatts of solar-panel capacity and 4.3 gigawatts of battery-storage capacity over the past 12 months. Such activities produced $3 billion in revenues—and $23 million in gross losses.

In the wings, says Musk, are the Tesla Semi (a Class 8 commercial truck), the Cybertruck (a futuristic-looking pickup truck), the Optimus robot, a fleet of self-piloting taxis, Full Self-Driving software (it's designed to pilot a vehicle) and more. At a TED Talk this April, the CEO said that robot revenues could surpass the automotive division's and that the first, non-human prototype will appear at the Tesla AI Day on Sept. 30.

It's part of the Tesla magic that the company gets credit for Musk's often unreliable words as well as for his actual deeds. Adam Jonas, a Morgan Stanley analyst, values the automotive and energy units at $232 per share versus the current share price of $282.94. One could argue, but the two units do operate.

A little more controversially, the analyst ascribes $143 in per share value to three business units that don't yet operate: mobility (self-driving taxis), a third-party parts division to supply other auto makers and a network-services unit that is expected to have 25 million customers paying $100 per month by 2030.

There's no gainsaying Tesla's manufacturing prowess, even as 417 non-Tesla electric vehicles have entered the market. "They were able to produce in China while other manufacturers struggled to launch their EVs under the pandemic," Jay Van Sciver, who rates Tesla a sell for Hedgeye Risk Management, tells me. "Even if you try to buy a Porsche Taycan, which is now an established EV in production, your build slot, if you go to buy it today, is probably going to be a 2023 delivery depending on which model you get."

Thus, Tesla's sales vaulted by 70.7% in 2021 and 80.5% in the first quarter of 2022. Growth decelerated to 41.6% in the three months ended June 30 on account of the temporary shuttering of Tesla's huge Shanghai factory (which is up and running again). "Tesla does not have a demand problem," Musk declared on the July 20 earnings call. "We have a production problem."

And a general-counsel retention problem. Tesla has churned through four chief legal officers since 2019. The world learned of the appointment of the latest to hold that role—Dinna Eskin—not from a Tesla-issued press release or an 8-K form filed with the SEC but in a document submitted in Musk's litigation with Twitter, Inc. (of which more below).

That Tesla came within a month of filing for bankruptcy protection as it ramped up production of the Model 3 in the two years till mid-2019 was the subject of a bombshell Musk tweet in November 2020. There's no sign of such distress today. On the contrary, as of June 30, a cash balance of $18.9 billion easily surpassed $4.4 billion in debt and leases and $5.3 billion in the kind of zero-cost debt called customer deposits and deferred revenues. Moody's and S&P rate the company Ba1/double-B-plus, respectively, i.e., on the cusp of investment grade.

The shareholders can count their

lucky stars that the 2018 "going private" transaction was a mere fire drill, since, from that time to this, the stock has returned 1,018% versus 37% for the S&P 500. Adjusting for splits, the fantasy $420 bid would amount to just $28 per share today, a tenth of the current price.

While Tesla gets mixed reviews from the Street (27 buys, 12 holds and 10 sells), the stock's sharp, options-assisted ascent has cleared out the nay-sayers, at least those not employed by Tesla. Year to date, insiders have sold 53.9 million split-adjusted shares for proceeds of $15.8 billion while no insider has bought. Executives not named Elon Musk accounted for $169.4 million of those sales.

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That Tesla's newest vehicle, the Model Y, is already three years old may surprise you. Model S, which debuted in 2012, generated peak sales in 2017, while the Model X, which came to market in 2015, made its top sales contribution in 2018. Time marches on.

"Interestingly, EV models that have been around for five-plus years have generally struggled to increase volume, perhaps highlighting the pace of innovation in EVs (i.e., the latest is the greatest, and is also more affordable)," Toni Sacconaghi, who rates Tesla a sell for Bernstein Research, noted in May. "We see this as a potential risk for Tesla over time should it not introduce new models."

Nor has time stood still for the Tesla brand. According to the 2021 *Consumer Reports* reliability report, Teslas are the second least dependable brand after Lincoln, a division of Ford. The March 3 issue of UK consumer-review magazine *Which?* found that EVs are overall less reliable than gasoline-powered vehicles and that Tesla is the least reliable of the EVs. While Tesla's direct sales model cuts out the middlemen, it likewise omits the service and repair functions that dealerships customarily perform. Tesla's online critics have taken note.

"Would you buy a Tesla over an EV from another brand?" is a question that Hedgeye periodically asks in customer surveys. In August 2018, 84% of respondents said yes; this June, the positive rate dropped to 59%, below brands such as Lucid Group, Inc. (83%), Ford (62%), Audi, a Volkswagen nameplate (80%) and Rivian Automotive, Inc. (75%). (As consumers may have a preference for more than one brand, these figures do not sum to 100%.)

Tesla's exemplary handling of supply-chain problems did only so much to close the gap between the demand for, and supply of, its vehicles. Backlogs have accordingly grown, to 504,000 vehicles in July 2022 from 257,000 in November 2021. That a self-proclaimed "Tesla addict," Troy Teslike, has made it his business to ferret out such data from public sources speaks volumes about the still-devoted Tesla fan base.

However, production may now be outpacing new orders, as the backlog fell to 414,000 in August and wait times to order a new Model 3 or Model Y are shortening. In China, which accounts for 24% of trailing sales, Tesla is offering a Rmb 8,000 ($1,130) incentive for qualified customers to take delivery between Sept. 16 and 30.

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An article in the Sept. 16, 2016 issue of *Grant's* examined the lives and works of a trio of industrial pioneers: Elon Musk, Thomas Edison and Nicola Tesla. "Edison viewed timelines as expressions of hope, rather than as hard-and-fast deadlines," we said. "So it is with Musk, only more so. Time is putty in his inventive hands."

Our piece quoted a passage from a *Wall Street Journal* story of August 2016: "In the past five years, Tesla has failed to meet more than 20 of [Musk's] projections, and missed 10 goals by nearly a year on average." The pattern has persisted. In January 2017, Musk predicted Tesla would have fully self-driving vehicles within six months. Almost six years later, the Full Self-Driving software is still in beta mode and has become the subject of investigations by the National Highway Safety Administration and the California Department of Motor Vehicles. A new class-action lawsuit alleges that Tesla's FSD does not deliver the claim in the name. The current Tesla 10-K, which designates FSD as an "advanced driver-assist system" and asserts that "the driver is ultimately responsible for controlling the vehicle," would almost seem to concede as much. Given that Tesla charges $15,000 per FSD unit, a recall could prove expensive.

The Tesla Semi was announced in November 2017 with initial production set to begin in 2019; the new start date is in 2023. The Cybertruck was announced in November 2019 with a 2021 target. A revised schedule has production beginning in 2023.

In April 2019, Musk promised that 1 million robotaxis would be on the road by 2020. To date, there are zero. GM's Cruise division, meanwhile, began a driverless taxi service in San Francisco, Calif., in June and is expected to expand to Austin, Texas, and Phoenix, Ariz., later this year.

Almost every autonomous-driving OEM uses a technology called LiDAR, short for "light detection and ranging," to detect oncoming objects. Tesla rather employs everyday cameras, which may explain why its software sometimes confuses the moon with traffic lights (first captured on video by Twitter user @JordanTeslaTech on July 22, 2021) and crashes into parked emergency vehicles (there are at least 16 such collisions). The National Highway Traffic Safety Administration is known to be investigating.

Musk's own balance sheet presents another risk to the TSLA stock price. As of March 31, according to Tesla's latest proxy statement, the world's wealthiest man had pledged 89.2 million shares as loan collateral. Two weeks later, on April 14, Musk bid $44 billion for every share of Twitter, Inc.

No, wait, it was a mistake, Musk decided. He didn't really want to buy Twitter, imperfect as he now understood that company to be. But Twitter wanted to be bought and is suing him to complete the transaction. If the courts side with Twitter, Musk will likely have to sell more Tesla stock. While he's said to have secured a total of $17.6 billion of financing, he would need $26 billion more to wrap things up.

As the remorseful owner of Twitter, Musk would continue to need cash, since the company showed a deficit in free cash flow of $852.5 million in the 12 months ended June 30 (a figure that was flattered by $800.3 million in stock-based compensation). Assuming that Musk chose not to dilute his stake in the social network, he would need $1.65 billion to plug the prospective 2022 hole. He would, indeed, need all that plus $258 billion more if class-action plaintiffs prevail in their recently filed suit against him for allegedly pulling the rug out from under the price of crypto token dogecoin.

However, observes Mark Spiegel, managing member and portfolio manager of Stanphyl Capital Partners, L.P., the biggest risk to the Tesla bulls lies not in the hands of a judge or jury but in the dynamics of the marketplace. He contends—and we concur—that Musk's pride and joy resembles Netflix, or perhaps Blackberry or other legendary first movers in a technology that eventually fell victim to a still-better product.

Netflix, Spiegel points out, is a business that commanded an "absurd valuation based on its pioneering position" but came crashing down to Earth as competition emerged and growth decelerated. If, as and when the same happens to Tesla, the corporate epitaph may simply read, "Another car company."

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