

Tesla Motors Is Going Bankrupt!

by InvestorAlmanac in Smart Money

Vilas Capital Management 4Q17 Letter

- Rose 65.1% in 2017, compared to 21.8% gain in the S&P 500

Current Environment

- World has become risk seeking instead of risk averse; appears that many investors seem to be more worried about missing out than worried about losing money
- Scarcity alone is not an investment attribute; diamonds are scarce, and they have been a lousy investment for many years
- When there is no income today or in anyone's reasonable time horizon, investing in those assets becomes pure speculation
 - This can be the only explanation for digital currencies and extremely high valuations for money losing or barely profitable enterprises
- We are witnessing a bubble today that is one of the poster children of the Greater Fool Theory, whereby a speculator needs to find a more foolish person than himself to sell his assets to

Current Positioning

- Roughly \$3.50 in long positions for every \$1 in short positions

- Profit on our “old economy” paired stocks such as Target, Kroger, WW Grainger, Walgreens, Express Scripts, Viacom, Daimler, Honda, GM, and Ford is roughly twice the amount that our glamour shorts, including Tesla, Amazon, and Netflix, have cost us
 - Long positions are trading at roughly 12x forward estimates while the glamour shorts are 200x earnings
 - There should be a spread but we see 20-25 as a better differential between high growth PE ratios and deep value (instead of 188)
- Fund is positioned with three main drivers of future returns: banks vs interest rates, Old Economy vs New Economy, and foreign vs domestic
- As interest rates, both short-term and long-term, rise with global economic growth, banks and insurance companies will benefit; banks need to keep a staggering amount of money in High Quality Liquid Assets, which in essence means Treasury Bills, due to regulatory requirements; further, higher rates will make banks more competitive vs wholesale lenders and captive finance companies as their branches finally begin to deliver the benefits of cheaper deposits
- Believe interest rates are too low and that long-term government rates should be 4-5% in a few years; typically, long term rates need to compensate owners for their willingness to tie up their money for many years, exposing them to interest rate risk
 - Looking at long term data, 10-year Treasuries tend to return 2% more than inflation; 30-year Treasuries return 3% more; given the current inflation level of 2.2% (CPI) that appears to be accelerating with higher oil prices and economic growth, our target for long term rates is derived
 - With 4% unemployment, rising house prices, and strong economic growth, it is simply a matter of time

for fixed income investors to demand higher rates of return for the risks they are bearing

- Holdings of auto stocks (Honda, Daimler, Ford and GM) have generated far more profits than our loss in Tesla and this should continue; holdings in retail, including Target, Kroger, CVS, Walgreens, WW Grainger, and Express Scripts, have outperformed our short position in Amazon
 - 12x earnings is better than 250x, regardless of the story
 - Pressures on the Old Economy stocks should subside due to lesser fears of their demise from their New Economy competitors, leading to rising share prices
- Have a material position invested in foreign stocks as they have generally lagged the US market badly and are far cheaper
 - Barclays is trading at 1/3 the price to tangible book multiple of JP Morgan
 - Fund has roughly 43% of net equity exposure in foreign names – entirely developed country exposures such as Japan, Germany, Switzerland, and the UK
- Vast majority of our short positions are domestic as the valuations in the US are far higher than elsewhere

And, Tesla

- Largest position, long or short
- Company cannot survive the next 12 months without access to capital from Wall Street Banks or private investors
- Estimate that Tesla will need roughly \$8 billion in the next 18 months to fund operating losses, capex, debts coming due, and working capital needs
- Appears that due to past SEC investigations and current investigations, it will likely be difficult for Tesla to access public markets

- There have been 85 SEC requests for additional information and disclosures in the last 5 years
 - This compares to Ford's total of zero over the same time frame
 - This means that Tesla is pushing many boundaries
- When a company is under formal investigation, it is difficult, if not impossible, to raise capital from public markets as these investigations must be made public, which generally craters the equity and debt values
- Tesla investors better hope there are a number of Greater Fools in China or elsewhere to keep the company solvent
- At some point, the music stops and there aren't any open chairs
- No matter how good a social investment makes you feel as it is going up, extreme anger will result if most or all of your money is permanently lost, especially when it is due to false and misleading statements by senior company officers

Image Source: Youtube