CAPITALIST EXPLOITS

INSIDER

Providing the world's Best Investment Ideas
from the World's Sharpest Investors.

TESLA: A SPECIAL UPDATE

As you know our strategy here at Insider is rather simple. Simple, but not easy.

Simple because we buy massively undervalued setups taking small positions and knowing we're going to have to deal with volatility that comes at the bottom of a market when liquidity has dried up and the few remaining actors on the stage are all hated and forgotten.

And then we wait patiently.

Not easy, because we humans are a fickle lot, and remaining patient and holding through volatility is a lost art. The greats — Buffet, Marks, etc. — understand this and have become richer than God on a good day in Vegas executing on it.

When, however, a sector starts moving, we will often re-evaluate and change allocations for our portfolio balance. It's not unlike us to double or triple our position sizing taking it into the teens. To "press the accelerator" so to speak.

What we typically tend not to do too much of is short. Short selling is an art in itself and often doesn't allow us the most valuable thing of all — time and the ability to be patient.

All too often we have to be right on price and timing. And so we do it. But rarely and even then not with the gusto we tend to muster for long positions.

Which brings me to Tesla, where we believe both timing and price are now at a point where we can freely press the accelerator more than we already have.

Also, I'm aware that there are many subscribers who haven't been with us from the beginning and who have some positions on, but not others.

If that's you, then this update is important because we'll cover what we would do if we had no positions at all in Tesla.

And for those with a position but feeling it's not big enough... well, this is for you too.

First, a look at the chart, because charts for me manage to encapsulate so much.

This is not a pretty chart.

Let's Review

Going back to 2018, the Tesla story was all about the Model 3 production ramp to 500,000 cars per year. This would have been consistent with what the market was pricing Tesla as — an "explosive growth story".

The numbers being bandied about by Musk and the bullish analysts projected profit growth that would explode allowing the company to pay off suppliers who were behind on payments (a clear sign for anyone paying attention that isht wasn't being handled properly) and build out even more capacity to meet the "limitless demand" the Musk kept talking about.

Unfortunately or fortunately (depending on one's position), the only thing "explosive" has been the cars.

And a few weeks later, another one exploded in a Hong Kong parking lot, 30 minutes after being parked. Thank Zeus (he was lord of lightning and the sky), the driver wasn't inside.

Tesla Model S catches fire in Hong Kong parking lot ecoti.in/k6AD4a17 via @ETPanache

Tesla Model S catches fire in Hong Kong parking lot
The electric car burst into flames 30 minutes after being parked.
economictimes.indiatimes.com

I've long bemoaned the absolute financial spaghetti that is Tesla accounting and financial statements. It really is something, and I suspect years from now will be used in university courses on accounting fraud.

In any event, these guys categorize a lot of production costs into capex (a neat trick done many times before by other scumbags). They include things like repairs and unsold cars (lemons) as capex. What this does is makes the profit margins look better than they actually are. Just keep shoveling opex costs into the capex column and bingo, your "margins" miraculously go up.

Now, the reason you want to make it look like your margins are high and increasing is because remember, this is a "growth stock" and folks love the growth story. They envision the next Google or Amazon are within their grasp and right after clicking the "buy" button on their Schwab account begin looking through the holiday homes listings in the Carribean.

So yeah, to keep the dream/fiction alive, "margins" have to look great.

Not only does it allow for the Ross Gerbers of the world to keep dreaming about that Carribean getaway pad, but for the somewhat risk averse folks who tend to look at the liability column, it provides a wonderful narrative that the expanding future profits will enable easy debt repayments as the cash pours in. It's also why the carnival barker kept saying, *"Nooo, we don't need to raise."* Cool, huh?

So with "margins" expanding (except as you can see, they weren't), the other part of this grand fiction needed solving: Limitless demand.

And so there is this wee problem of registration of VINs. You see, it's like when I dress myself — nothing matches.

We can see the production coming out of the factory, but when the cars are sold, the VINs are registered. What happens if they're not sold, I hear you ask? Well, then the fraud is revealed, and so this is why all over the good ol' US of A there sit dusty Teslas. Gotta stick 'em somewhere, right?

What this means is that reality of "limitless demand" is that… well, it isn't quite there. Demand is, in fact, collapsing.

We need only look outside of the US to Tesla's other markets where demand is disappearing faster than the snack food at a Jenny Craig meeting. Can't dick around with VINs in Europe and pretend demand is something other than it is.

It's been frustrating to watch all of this go on so transparently (provided you know where to look)... and yet the stock failed to collapse (as it should have done).

Right after Musk decided to produce cars in a tent in the parking lot they should have just called it quits, filed for Chapter 11, and saved what there was to save.

But we're not talking about ethical people here. We're talking about Musk, who is a serial liar, and so given that he'd already defrauded Tesla shareholders spectacularly by "acquiring" SolarCity (which is now not even talked about because it's simply acknowledged that yes, it's bust)... and so when in deep, you keep digging deeper, right?

Elon's wealth is mostly tied up in loss making grandiose schemes, which have managed to sport unbelievable (literally) valuations and against which he's borrowed hundreds of millions of dollars to fund his lavish lifestyle.

If those fictions were to be revealed for what they are (fictions), his net worth would collapse. EVERYTHING that Musk is involved in needs fresh dump capital. Every single one. Much of his assets are cross collateralized, and so the spectacular empire he's built (one of the "growth" narrative) could come crashing down if Tesla fails.

He realises this, and so in such a sticky situation what do you do? You don't want to give up your G5 jet or your multiple homes. So you carry on and dig deeper.

At this point I'd like to point out how Musk operates by showing you SolarCity. Once you read the method you'll recognise it in the "up front, non-refundable" deposit scheme he used on the Model 3, the Roadster, and the Semi (still not arrived, and I suspect will never see the light of day).

SolarCity was "profitable" because they subsidized leases. That is, until the obligations of servicing the roof tiles came up and then... well, it wasn't profitable.

Here's how it works. Customers agree to pay for 20 years, and SolarCity agreed to service the powerwalls and roof tiles. Tesla securitized the leases, collected the dough, and then began defaulting on the service obligations. Cool trick, huh? Except the lawsuits are piling up.

It's the same thing with the Roadster and the Semi.

Flog an idealistic dream to folks making them feel good, because you're "saving the planet" or "landing shit on Mars" or whatever the folks want most to hear, collect the cash, and then find excuses as to why delivery is late.

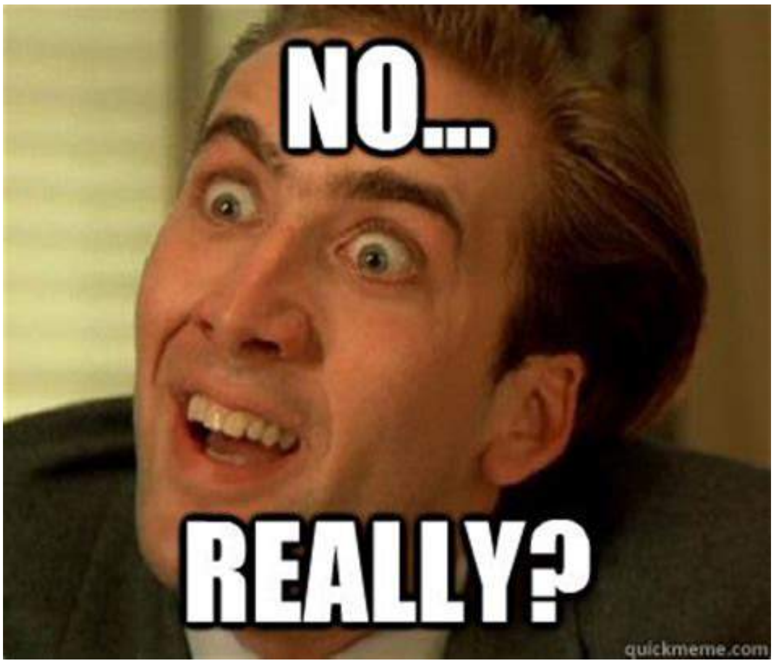
Where, for example, is the Roadster, Model Y, Semi truck?

The folks who put down-payments on these unknowingly became unsecured equity owners in an insolvent company headed for bankruptcy. It sucks. They won't get a penny back, and I feel sorry for them. That's a shitty thing to have happen to well-meaning folks who've put down hard earned money. But that's what all frauds look like.

Here at HQ we are pretty confident the gig is close to being up!

Demand has collapsed, we know this. Tesla simply hasn't enough money to make payroll, which is why they've been closing down stores and laying off the workforce faster than a speeding ticket. And now, in desperation, they've raised money via convertible debt mostly and a sliver of equity (more on this shortly).

Bulls have begun to question the story (T. Rowe, their largest institutional holder, have dumped almost all their stock now). Lawsuits are piling up. And not only are management distancing themselves (though admittedly, this has been going on for years now), but so, too, are the institutional bulls. Right now, this stock is mostly held by, you guessed it, retail.



Yes, really.

What's going to save this?

Nothing. Musk, in desperation, tried a trick that's worked well in the past. Distraction. Remember flamethrowers, Tesla bricks, and tunnels?

Well, he just wheeled out "1 million robotaxis by 2020". That is 6 months away. Pray tell, how's that going to happen?

Musk has already been forced to backtrack on his full self drive (FSD) narrative and independent auto reviews have revealed that competitors' self drive technology is ahead of Tesla, though none of Tesla's competitors have been stupid enough to suggest to drivers to actually use it, knowing that it needs to be 100% accurate because that 1% is deadly. So FSD isn't getting the attention Musk had wished for because it doesn't exist.

Now, you'll realise I've left a ton of things out, not least of which are the lemons that have been built in a tent and have made their way onto the roads, only to fall apart, damaging the brand.

Then we have the wall of competition that is now on Tesla's doorstep with much better cars produced by reliable companies with balance sheets that don't look like garbage, which is important if you ever need your car serviced, repaired, or have warranty issues. All things that Tesla customers will have to deal with shortly.

And now I'd like to deal with a catalyst that looks to drive the stock lower still: The last capital raise.

How can that be, I hear you ask. After all, they just raised more dough. Surely that is a good thing?

Well, kinda. No, not really.

Understanding Converts… and Why Now is the Time to Press the Accelerator

Tesla raised $847.6 million from the equity tranche and $1.84 billion from the convertible debt.

Tesla hedged the converts and paid roughly $300 million to do so, which simply means that we can deduct this from the proceeds of this raise. So that brings us down to about $2.4 billion.

Ok, that sounds like a decent chunk of cash, Chris.

Not so fast, Batman. When we look at the debts maturing, they've just under $600 million due in just 4 months. In fact, they've a total (according to their own prospectus) of $1.1 billion in debt maturing this year and another $890 million due next year.

I'm not talking about the interest costs due either. This is the entire sum. Pay up time… or roll it. The question is, who's going to roll it... and at what cost?

So when you realise that in 4 months Tesla has to come up with $600 million in cash… and in 5 months a full $1.1 billion, you'll understand rather quickly why they had to raise cash fast.

Problem is they raised new debt to pay old debt. Ever seen a company do that before on worse terms and it was a positive?

Nah, me neither.

So anyway, let's deduct that $1.1 billion, shall we? I mean, it's gone in a few months, and so the nonsense that Musk spouted about this being "growth capital for expansion" is just that — nonsense.

So where were we? Right, $2.4 billion less the $1.1 billion leaves us with $1.3 billion.

Now we know from Tesla's own admission that they're running a $1.5 billion working capital deficit. That needs fixing.

Looks to me like we're outta bullets, folks.

No dough left for "funding production growth, R&D, or even putting in some nice water coolers for the workers. No. This capital raise was nowhere near enough to solve this company's dire financial problems... and it most certainly wasn't "growth capital". That Tesla suggested this is laughable.

Now, lastly, the folks who bought the convertible debt are probably not fools. They just see opportunity. So they buy the bonds, get a high dividend payment (because let's face it, this is junk and you need to be paid well for owning junk), but to hedge their position they'll simply go out and short the equivalent in the equity delta, hedging their entire position and picking up a tidy dividend. It's a good trade with no risk.

And what this means is simply more downward pressure on the equities.

Now, that I've had my little rant, the age old question of what to do about it all.

Let's go back and look at what we're holding and work from there, shall we?

Existing Positions

Our journey with Tesla has been one hell of a journey so far. As per usual, it is a story of **"things taking way longer to work out than you would 'reasonably expect."**

Our initial Tesla alert was published in early June 2017. The position we put on was a January 2019, 100/50 bear put spread at 2.30

Our thinking here was that Tesla's fall was going to be a relatively quick affair and that it would fall back to where it's dramatic bull market started, which was about 50.

We didn't want to short it, even though we were not too far from the ultimate top

To buy puts outright just didn't make sense to us as they were way too pricey and **we couldn't get any respectable payoff for the risk taken.**

So we went for the king hit — a long dated way OTM bear put spread. This would have given us a 20:1 payoff it Tesla had closed below 50 come January 2019.

Come February 2018 we decided to buy ourselves more time and rolled the January 2019, 100/50 spread to a January 2020, 100/50 spread and in doing so it **cost 46% more** (so we lost 46% on the initial trade).

Come February 2019 we repeated the process… rolling the January 2020 spread to a January 2021 spread. We were able to get out of the February 2020 spread at more or less our entry price.

So we now sit with a January 2021, 100/50 spread at 7.78. This will give us a 5.5:1 payoff if Tesla trades below 50 come January 2021. And if it does, we will end up with a 300% return (taking into account what we lost in the first trade).

Assuming it all comes home, what lessons are there to be learnt here?

You might think that 2 years is a long time but it isn't. Granted, we didn't expect the Tesla trade to come home on our first trade, and thank goodness we bought the spread and not the outright puts. And thank the gods we did roll our contracts a couple of times and buy more time to keep us in the game.

It would have been soul destroying to be 100% right on the view and have a 100% loss to show for our efforts (I know of fund managers right now who will come out of this trade with a net loss even if Tesla goes to zero tomorrow as they've been short but not position sized as we've done and not bought the spreads).

And this is all while Tesla is still alive and kicking, and we don't know how long it lives for.

Sure, I think that we can wake one morning to find that it opens $100 lower and continues to plummet rapidly filing much sooner than most expect, but things are never a given and smart investing involves smart risk management.

So what can one do here and now? We won't even entertain the idea of going short directly even now.

As far as options go, we won't consider any time less than the maximum we can go out: January 2021. I've never regretted buying as much time as I possibly can, and I don't think now is the time to change that line of thinking.

Once again, the big issue is going to be getting a reasonable payoff, and we would like to have at the very least a 3:1 payoff. Given how expensive the options are, this is a demanding task, and it will force us to look at bear put spreads once again.

Let's take a look.

An ATM (at the money) put: January 2021, 220 strike will cost 53. So to get a 100% return, Tesla has to close at 114 come January 2021 — a 50% fall. If Tesla gets to 61, then its a 200% return, and at 8, it's a 300% return!

So to get a 3:1 payoff from a January 2021, 220 put, Tesla essentially has to go bankrupt (i.e. to zero).

How about an OTM (out of the money) put?

A 100 strike will cost about 12. This gives us a 3:1 payoff a 50, and max payoff of 7:1 if Tesla goes to zero.

And bear put spreads?

Our January 2021, 100/50 spread will cost about 7.8, which gives a 5.4:1 payoff if Tesla closes below 50 come January 2021.

And if we took a "go big or go home" attitude, **the January 2021, 50/25 put spread that will cost 2.25 with a 22.5:1 payoff if Tesla closes below 25 come January 2021.** Below is how the trade would appear on the IB platform.

It's more of a long shot, but we remain convinced this charade will end in bankruptcy. Timing is the concern… as you've no doubt seen. This trade (the 50/25 spread) could very well work out come January 2021.

So there you have it. The view and how to execute it with multiple options for you to pick from… and hopefully a deeper understanding that — while the view may be correct — it's actually rather difficult sometimes to profit spectacularly, especially on the short side.

Sincerely,

Chris MacIntosh

Founder & Editor In Chief, Capitalist Exploits Independent Investment Research
Founder & Managing Partner, Glenorchy Capital

Unauthorized Disclosure Prohibited

The information provided in this publication is private, privileged, and confidential information, licensed for your sole individual use as a subscriber. Capitalist Exploits reserves all rights to the content of this publication and related materials. Forwarding, copying, disseminating, or distributing this report in whole or in part, including substantial quotation of any portion of the publication or any release of specific investment recommendations, is strictly prohibited.

Participation in such activity is grounds for immediate termination of all subscriptions of registered subscribers deemed to be involved at Capitalist Exploits. Capitalist Exploits reserves the right to monitor the use of this publication without disclosure by any electronic means it deems necessary and may change those means without notice at any time. If you have received this publication and are not the intended subscriber, please contact admin@capitalistexploits.at.

Disclaimers

Capitalist Exploits website, World Out Of Whack, Insider, and any content published by Capitalist Exploits is obtained from sources believed to be reliable, but its accuracy cannot be guaranteed. The information contained in such publications is not intended to constitute individual investment advice and is not designed to meet your personal financial situation. The opinions expressed in such publications are those of the publisher and are subject to change without notice. The information in such publications may become outdated and there is no obligation to update any such information. You are advised to discuss with your financial advisers your investment options and whether any investment is suitable for your specific needs prior to making any investments.

Capitalist Exploits and other entities in which it has an interest, employees, officers, family, and associates may from time to time have positions in the securities or commodities covered in publications or the website. Corporate policies are in effect that attempt to avoid potential conflicts of interest and resolve conflicts of interest should they arise, in a timely fashion.

Capitalist Exploits reserves the right to cancel any subscription at any time, and if it does so it will promptly refund to the subscriber the amount of the subscription payment previously received relating to the remaining subscription period. Cancellation of a subscription may result from any unauthorized use or reproduction or rebroadcast of any Capitalist Exploits paid publication/s, any infringement or misappropriation of Capitalist Exploits proprietary rights, or any other reason determined in the sole discretion of Capitalist Exploits.

Affiliate Notice

Capitalist Exploits has affiliate agreements in place that may include fee sharing. If you have a website and would like to be considered for inclusion in the Capitalist Exploits affiliate program, please email admin@capitalistexploits.at. Likewise, from time to time Capitalist Exploits may engage in affiliate programs covered by other companies, though corporate policy firmly dictates that such agreements will have no influence on any product or service recommendations, nor alter the pricing that would otherwise be available in absence of such an agreement. As always, it is important that you do your own due diligence before transacting any business with any firm, for any product or service.