

Demetri Kofinas: What's up everybody? Welcome to this week's market forces segment of the hidden forces podcast with me Demetri Kofinas. Today I speak with Charlie Grant, a columnist for the Wall Street Journal, where he covers US healthcare and industrial companies, including the electric car company, Tesla, which he has been writing critically on since [00:00:30] 2015.

In his previous life, Charlie was a reporter at Grant's Interest Rate Observer and is a CFA charter holder. Charlie, welcome to hidden forces.

Charley Grant: Hey, thanks for having me.

Demetri Kofinas: How'd you like my little intro there?

Charley Grant: It was smooth.

Demetri Kofinas: You didn't give me much else to work with man.

Charley Grant: Yes. Well, we have tight word counts at the journal, so I keep my bio in similarly very tight fashion.

Demetri Kofinas: That article you guys wrote that we're going to get into. We're going to get into the SolarCity acquisition, but I could tell it [00:01:00] was a few people, it was you and two other writers on that, right?

Charley Grant: That's right, yes.

Demetri Kofinas: But I could tell that one of the comments about flattering the balance sheet that came from you.

Charley Grant: That might be a Grant family or something, yes.

Demetri Kofinas: Exactly. So, we're big fans of Grants Interest Rate Observer here. And that conference is coming up now to. Next week actually I think, the week after. Charlie, I'm very excited to have you on. It's been ... I've known you now for since 2011 or-

Charley Grant: 12, something like that.

Demetri Kofinas: 11 or 12. This is the first time you're on the show, but you've become a [00:01:30] really a prolific tweeter and you've amassed quite a following.

Charley Grant: Shout out to Jack Dorsey, you made an addictive platform.

Demetri Kofinas: And you've been writing about Tesla for at least since 2015 and I've just caught wind of it just from twitter. I know you've been doing a lot of great work on it and it's something that I haven't had opportunity to cover on this show because of all the other stuff we cover. But given what's been going on in the news lately and the fact that I

think Tesla is at the intersection of a lot of these forces that we cover, [00:02:00] the growing income wealth gap, the availability of cheap financing, the allure of technology and the way that it captures the dreams and aspirations of this bull market, and just Elon Musk's role as an icon for this, for this bull market.

I think it's a really interesting story. I want, for my sake and for our audience's sake ... Oh, and before I even say that, I got to say, I'm trying to do this not because I'm doing more finance [00:02:30] shows. This is not financial advice, don't sue me. That's what I said when I had Brian Kelly on.

Charley Grant: This is definitely not financial advice.

Demetri Kofinas: What's the official way you do that?

Charley Grant: That's clear enough. Yes, I prefer plain English to boilerplate legal language, not investment advice.

Demetri Kofinas: All right. I have a bunch of quotes here that are really cool, but I'm going to pull up a couple of yours before we start. One of them is, this is from October seventh, "It's high time for Tesla and Wall Street to acknowledge reality." This [00:03:00] is both from you and my favorite is, "CEO, Elon Musk, is a visionary but there's a fine line between setting aggressive goals and misleading shareholders." Very direct, Charlie.

So this is what I want to talk about because you're not the only one that's been talking about this. Tesla has been ... Controversy has surrounded this company since day one. I mean one way or another, but there's been an ebb and flow of it and it seems to have really hit a critical state recently. So maybe you can give us a timeline history of Tesla. I think the company was [00:03:30] founded or began operations in 2003. It went public in 2010 shortly after it produced its first car.

Charley Grant: The Roadster yes.

Demetri Kofinas: Tell us a little bit about this company's history and how we got here.

Charley Grant: Right, Elon Musk started ... He published his grand master plan on the Internet. The idea was to build luxury electric cars for a few ultra-high-end product, make some profits off that, reinvest those profits into building [00:04:00] a mainstream electric car, which is what we all know now as the model three, and that would launch a new era of electrification and some of the things that come with that, self-driving capabilities, that sort of thing. Ride-sharing, a lot of what silicon valley envisions for the automotive future.

In some ways he's accomplished almost all of those goals. The model S started being built [00:04:30] on mass in 2013 or so. Tesla narrowly averted bankruptcy, people saw this great car. It's a great car. I want to be clear about that.

Demetri Kofinas: Have you ever driven one?

Charley Grant: No, but I've ridden in it and-

Demetri Kofinas: It's amazing.

Charley Grant: - on a reporter salary, a high-end Tesla is not really an option in this business, but it's a great car. The allure of the product certainly has helped propel the rise of the business. But, what Tesla has in many ways satisfied what its [00:05:00] visionaries and its early disciples, if you will, they are disciples in mind, but where the master plan deviated from reality was that Tesla was building these cars, not from reinvesting their own profits.

They've never made any meaningful profit but from the continuous generosity of the capital markets. They've been regular raisers of equity. They've raised significant debt in recent [00:05:30] years. Convertible bonds eventually turning into pure fixed rate instruments and Wall Street's been all too happy to fund this, but the profits never really materialized and it has created this situation where Tesla ... You alluded to all this controversy where they make these great products and they get these fans that are truly passionate about them. I have the emails to prove it.

Demetri Kofinas: You get a lot of emails.

Charley Grant: Oh yes. Readers have a right to chime [00:06:00] in with their feedback and they give it to me.

Demetri Kofinas: Have you ever gotten any interesting bull arguments for Tesla?

Charley Grant: Sure, we can get to those in a minute, but this is where the flashpoint is because the bears, like myself, will say, "Well, you've never made a business that can stand on its own and capital markets access comes and goes." Where Tesla has had this high stock price and bigger valuations and Ford and GM and that thing, but they still been really living hand to mouth on a year to year basis and [00:06:30] sooner or later, that catches up with you.

Demetri Kofinas: And you think it's caught up to them now at this point?

Charley Grant: I think that that's part of the reason why we've seen the stock go down so much in the past month or so.

Demetri Kofinas: So with the roadster, were they profitable? Did they have gross profits at that time?

Charley Grant: There were spot periods like in 2013 where they made a narrow gap profit.

Demetri Kofinas: When did they release the model S?

Charley Grant: Around then, early to mid-part of this decade. So 2012 2013.

Demetri Kofinas: There was a time with the model S window [00:07:00] where, I think, sentiment generally improved tremendous on the company.

Charley Grant: Yes because they had averted bankruptcy and the car was here and people could see how cool this thing was and they were not wrong about that. I want to give credit where it's due and it was heavily shorted at the time as it has been-

Demetri Kofinas: When was this?

Charley Grant: Around 2013.

Demetri Kofinas: 2013.

Charley Grant: And the stock went from somewhere around 20 bucks to 200 in the year. It just rocketed and there have been bumps in the road here [00:07:30] and there since then. But more or less it's been a smooth ride higher at least if you just you look at things from a stock market perspective. If you look a little deeper, things start to get a little more iffy for this business.

Demetri Kofinas: Well, it seems like you don't have to look very deep to see that.

Charley Grant: At this point no, but yes.

Demetri Kofinas: I have not engaged really deeply with Tesla or the car industry more broadly. And what I did pretty much beyond just the general hearsay that [00:08:00] I've gotten over the last few years was in the last two days after I spoke to you and I said, "Listen, Charlie, I want you to come on. Let's talk about this." And I spent the last two days going through the financials, checking some stuff out, and it looks scary and it looks obviously scary.

Charley Grant: I think so yes.

Demetri Kofinas: So, I also did some ... In my research, I saw some interesting things that Jim Chandler said specifically. The one thing that really stuck out to me was that he had put together a spreadsheet with all the executive departures of the last two years and he compared the company to Enron. And of course, [00:08:30] Jim Chandler famously shorted Enron in the early 2000's.

For him. He talks about what he calls the dark turn, which was the acquisition of SolarCity by Tesla in 2016, I believe.

Charley Grant: Yes.

Demetri Kofinas: Where does that sit in your view in terms of the trajectory of this company? Was that really a fateful turn? Was it more something that illuminated what was already company practice? Practiced by Elon Musk or did it really embolden him to begin to act in a way [00:09:00] that breaks perhaps with his fiduciary duty?

Charley Grant: Well, so I think that a lot of the problems we are seeing today with the current stock price slide and Tesla's signature bond issue trading in the mid-eighties on the dollar well below par sign of significant financial stress. I would say the SolarCity acquisition is a huge part of that. The stock market, of course, loved it at the time because SolarCity was experiencing significant financial stress.

Demetri Kofinas: [00:09:30] Talk to the audience, for those who don't know, tell them what SolarCity is, give them the backstory on this.

Charley Grant: Sure thing, sure. SolarCity was another Elon Musk project. He wasn't CEO, but he was chairman of the company and its largest shareholder and that's the rooftop solar panel, clean energy business, which in theory doesn't really have much to do with manufacturing and automobile.

So SolarCity was another high flying stock, but solar accounting is very complicated. The technology is [00:10:00] changing rapidly. Solar prices, the economics of installing solar on a roof, like an electric car but not really ... Interesting and you'll get adopters, but the industry is still young and hasn't figured out a way to make the economics work. That's a common thread here.

Demetri Kofinas: The solar industry.

Charley Grant: Solar industry, and also true for the auto. I'm talking about solar now, we can talk about the auto issue.

Demetri Kofinas: Those are two different paths to in solar. One is the large solar [00:10:30] fields like the stuff we see in Arizona.

Charley Grant: Sure.

Demetri Kofinas: Versus the idea of having each individual home fitted with solar.

Charley Grant: Yes. I'm talking about the rooftop business specifically being problematic here. So SolarCity, you're securitizing these assets, so your balance sheet automatically becomes very heavy with debt. SolarCity stock price was falling, the bonds were trading at distress levels and it really looked like the company might not survive.

Demetri Kofinas: Did this start in 2015?

Charley Grant: 2015 [00:11:00] was when the problem started to appear, 2016 they got acute. In June 2016, Tesla announced that it was buying SolarCity and Elon Musk is the

largest shareholder of both companies and the chairman of both companies and these two businesses don't really have much to do with each other.

Demetri Kofinas: So let's talk about a second. What percentage of SolarCity did Elon Musk own?

Charley Grant: I'm not sure off the top of my head, but significant chunk, double-
[00:11:30] digit ownership. I think in the twenties, close to Tesla, which is, he owns a little more than a fifth of Tesla and a similar percentage of SolarCity. So not the majority owner, but enough to make something happen, especially when you're also chairman of the board. And so this deal seemed ... From us, we were in complete shock. I mean this is ... Shall we say, not in accordance with traditional corporate governance practices to do this sort of thing.

But [00:12:00] the deal closed, SolarCity seemed to be saved because they had the Tesla's access to the capital markets, which made some people think that these debt problems might be resolved. Tesla share price took off right after the acquisition again. It had fallen down to the high \$100 range, 180 something like that. And at its peak last summer, the stock reached into north of \$380 a share.

Demetri Kofinas: Well, didn't its market capture surpass GMs?

Charley Grant: Yes.

Demetri Kofinas: [00:12:30] Which is remarkable when you look at the number of cars it's manufacturing versus the number of cars that GM's manufacturing. To interrupt here, to interject perhaps a better way to put it, we did a show over the summer with Hubert Harun, the transportation analyst on Uber. Similarly, there are some similarities for me between Uber and Tesla specifically in terms of the secret sauce hope or expectation that investors have around that justify the valuation.

[00:13:00] The idea that in the case of Uber, that the application and the routing system would allow the company to overcome the losses to economies of scale generated by the traditional taxi limo industry and similarly with Tesla, the idea that they would be able to have a market cap larger than GM which produces however many millions of cars?

Charley Grant: Millions.

Demetri Kofinas: 11 million or something, or VW. I had this number here VW does it. GM is just under 10 million cars. I guess the [00:13:30] idea of that is that they have some really incredible head start on the future which is electronic vehicles and techno-

Charley Grant: Exactly. So the idea is a decade from now, we'll all be driving Tesla's, we'll all be using uber. In both cases What makes these companies so disruptive to the traditional incumbent players is that investors are willing to fund the losses at absurd levels.

Tesla at one point was losing about \$20000 on a [00:14:00] gap net income basis per car sold. GM and Ford shareholder base just simply won't tolerate that thing. And that makes it for a significant disadvantage though from management teams when you change your strategy. So, that's to your point, and at the top of this broadcast about macroeconomic low-interest rates, easy credit, is a very common thread between Tesla and Uber and a lot of these other so-called disruptors that you see in the market. [00:14:30] That the willingness to fund losses is something you only see when money is easy and you can just tap the markets again and again. And that becomes the zeitgeist or the thought process of investors.

That can take you very far, but if you don't build a sustainable business then you have a very high diving board that you're at risk on.

Demetri Kofinas: So Tesla was founded in 2003. It sold the first car in 2010. That was shortly after the market peak that over \$ [00:15:00] 140 a barrel. Right?

Charley Grant: Oil.

Demetri Kofinas: There were expectations that we would see \$200 a barrel. Certainly, no one expected that we would ... Not no one, I'm sure There were people that did, but many people were caught flat-footed by the fracking revolution and-

Charley Grant: Caught me off guard.

Demetri Kofinas: It caught me off guard as well. And so how much of a role do you think that has played in acting as a headwind for Tesla in its attempt breakthrough as a startup car manufacturer?

Charley Grant: Well I [00:15:30] think that's one reason electric cars are still niches. I think Bloomberg reported a year ago or so, that GM's electric car, the Chevy Bolt, which is not particularly-

Demetri Kofinas: That was Bob Lutz's project wasn't it?

Charley Grant: Yes, he's been gone awhile, but yes I mean the electrification ... That car is celebrated but they're losing \$9000 on every one they sell so they can't build that many of them.

Demetri Kofinas: Do they not [00:16:00] get subsidies on those?

Charley Grant: They do, but the economics still don't work. The buyer gets a subsidy.

Demetri Kofinas: And that's a particularly American phenomenon, right? Because in Europe I assume that these cars are more popular.

Charley Grant: They are, yes. And also because gas-

Demetri Kofinas: Is more expensive.

Charley Grant: - tax is there and that sort of thing. Here in America, the opportunity cost to owning a gas guzzler is much lower and people want big Ford F one fi ... Tesla is very popular on the coasts and in New York and San Francisco and those places. [00:16:30] But there's a great middle in this country and SUVs, pickup trucks, that sort of thing are still the name of the game. When you have access to cheap gasoline, the opportunity cost-benefit of driving electric is thin.

That's been an issue holding back electrification more generally. That's not really a specific Tesla issue beyond the fact that they're all-electric cars, but [00:17:00] that's an issue that GM and other guys trying to break into the market in the US face.

Demetri Kofinas: So I mentioned subsidies there. Subsidies have played a huge role in Tesla's growth.

Charley Grant: It's part of the controversy to.

Demetri Kofinas: Okay, well talk to me a little bit about that. I mean we talked about the debt that's going to keep coming in and out. I do want to talk about the economics of these cars, but let's talk a little bit about the subsidies and maybe you can tie that into what the cost is of building roadster ... Well, they don't have the roadster anymore, they have a new supposedly roadster [00:17:30] that's going to come at some point, but the model S, the model three, the cost of actually creating one of these vehicles, how much they can bring in theoretically with them, or they are bringing in, and how that all ties in with the subsidies.

Charley Grant: So there's a few different ways these subsidies work and there's not one coherent policy here. We're going on, but there's the federal tax credit for an EV buyer, you get up to \$7500 for qualifying electric car [00:18:00] as a tax rebate. And that applies for the first 200000 cars that in the US that manufacturer as a brand. So Tesla, all of GM would fall under that umbrella. No one's hit that number yet, but people think that this year sometime tesla will cross.

Demetri Kofinas: Which is why they're going to lose the subsidy.

Charley Grant: They wouldn't lose it right away under current law. It would be you have a six month grace period once you sell the \$200000 car and then it tapers gradually. So you [00:18:30] probably take another year or so before it went away altogether but that's the buyer tax subsidy. In California, there are state-level credits for EV buyers as well that can also lower the consumer's bill and the manufacturer because of zero emissions laws.

So if you make a polluting car, you've got to make a clean one. And so a lot of manufacturers will sell what are known as compliance cars to comply with the regulations but not necessarily a product that they're going [00:19:00] to be [crosstalk 00:19:00] or just not featuring in terms of a bottom line how they plan to make money in the auto business.

So you earn what are called credits, zero emission credits and you can satisfy your emissions requirements either by building a clean car or by buying the credits from someone else. So Tesla, since they only make electric cars, zero emissions-

Demetri Kofinas: They're able to sell those credits.

Charley Grant: - they have those credits they can sell and that's been an important revenue source. Because that's very high [00:19:30] margin. It's a small part of their overall revenue, but the margins on that are 100 percent essentially. So that's certainly helping keep the finances a float somewhat.

And then there's also noneconomic incentives, you've ever driven in California if you have an electric car, you can use the Hov lane even if you're by yourself.

Demetri Kofinas: That's also true here as well.

Charley Grant: Yes, but in particular in California, that seems ... I have to confess that's something I'd be willing to pay for if I lived there. [00:20:00] It's not a pure financial subsidy, but it matters when you're considering whether to buy one. This company becomes political because some conservatives don't really like the idea of tax subsidies and so there's that angle of the controversy with Tesla and ...

Demetri Kofinas: But let's say, just in terms of, if I'm looking at the financials of this company, and I'm taking into account the subsidies and I'm taking all of this stuff into account as I'm looking at what the costs are and what the revenue prospects [00:20:30] are and what the prospects of profitability for this company. Realistically, when you look at the financials here, what is the path to profitability for this company?

Charley Grant: I don't see one.

Demetri Kofinas: You don't see one at all?

Charley Grant: No.

Demetri Kofinas: So why is that not reflected in the stock price? How do you account for that?

Charley Grant: Well, it started to. See, I differ with the broader market on this.

Demetri Kofinas: Sure well you differ for a while about it.

Charley Grant: Yes and I've been wrong. There's a term for that. I don't want to shy away from that and prote ... Some of my predictions have been premature, [00:21:00] runs in the family.

Demetri Kofinas: Actually the audience may not know this, but your father is Jim Grant who had been on the program and he's made a comment before here that I really liked, which actually Josh Wolfe also repeated on his own separately, which is, that your dad had said, Jim had said that we at Grants like to think that we would like to be right later.

I told you I had spoken with Mark Spiegel a couple of days ago and he's going to be on the program next Monday to talk about this exact same thing, [00:21:30] and he's been shorting the company for like four years or something like that. So you can be wrong for a long time before you're right.

Charley Grant: Yes, absolutely. That's the way markets work.

Demetri Kofinas: Of course, but to bring it back to that, which is that the market ... And this feeds back to the bull story that Tesla looking back, it may end up being one of the iconic companies of the bull market. So it's not uncharacteristic. Of course, you have manias and stock prices, but I am curious, how does the market rationalize the price and what are some of the other factors?

For example, [00:22:00] there has been a willingness by different funds to invest in Tesla. What is the rationale for the price currently?

Charley Grant: Well, the bull argument is still that this company is going to dominate the future of the auto industry 10, 20 years out and bulls who have more sophisticated arguments around this than others. But the gist of it is essentially I'm willing to endure the short-term, ups and downs of manufacturing. Eventually they'll figure out how to mass produce [00:22:30] a car like all the GMs and fords, but they'll just have much nicer products that everyone will want. And eventually they'll gradually push these other guys to the sidelines of the auto business and 10, 20 years out Tesla will have 40, 50 percent market share.

Demetri Kofinas: But let's talk about that because I've tried to follow those bull arguments, and what I was hoping or expecting to find was that there would be some interesting proprietary piece of technology that Tesla has been developing, for example, in autonomous driving. [00:23:00] To my surprise, from what I understand, they don't have a single patent on autonomous driving. Which is surprising, for me, considering that they're a technology company located in Silicon Valley and that this is supposed to be the future.

And so much of what I think defines them in the popular mind is that they're a technology company, technology car.

Charley Grant: That's a lot of hooley. They're a car company.

Demetri Kofinas: So they're an upstart car company.

Charley Grant: Yes.

Demetri Kofinas: In terms of ... I'm putting on the spot here to give someone else's argument, but I'm just trying to understand [00:23:30] what the coherent argument that the Bulls are making is. How could you get there? If you needed to get there, if you want to make the case for them?

Charley Grant: Well, part of it is that only a small percentage of Americans have tried this car and the idea is once you try this, you'll never want to drive anything else.

Demetri Kofinas: That is a pretty awesome experience.

Charley Grant: Yes.

Demetri Kofinas: But the question is, is that the experience of driving a fast electric cars? Is it the experience of driving a Tesla? And I think, what is it? Audi, BMW, Porsche, Mercedes. [00:24:00] These companies are all going to be coming out with fully electric vehicles.

Charley Grant: And that's a huge part of why I think that Tesla's hard times are just only starting to begin here, is what you just said. The competition has been ... Tesla had a huge head start. They were more serious about this front than any other company. Legacy automakers were slow to realize how popular electric would be, how in demand this would be on Wall Street, that sort of thing. And [00:24:30] so that gave Tesla huge leg up and this is all credit to Elon musk that he has inspired the rest of the industry to get serious about this, but now you have these experienced car makers. Porsche's no joke in terms of making a nice car. Right?

Demetri Kofinas: It's a gorgeous car.

Charley Grant: Then it's going to be all electric, I'm not sure any one of these individual brands how big of a seller they're going to be, but with Jaguar unveiled their new SUV to compete with Tesla SUV.

Demetri Kofinas: But I've seen some of these [00:25:00] have prices below the model S, right?

Charley Grant: Yes

Demetri Kofinas: And these are beautiful cars. If you at look at them, they're very attractive.

Charley Grant: Exactly. It's one thing to say a Chevy volt can't compete with a Tesla. I agree with that. That's factual.

Demetri Kofinas: And that was the paradigm before Tesla. That's what Tesla innovated, right? Elon musk supposedly was traveling around silicon valley, going to garages and seeing people would have a Porsche parked next to a Toyota hybrid. And he

said essentially the people want ... They want an electric vehicle, but they also have the money to spend for a ...

Charley Grant: [00:25:30] Yes. And that was a completely valid market segment that they've gone after. I think Tesla made a mistake though in trying to become a mainstream auto manufacturer.

Demetri Kofinas: The model three.

Charley Grant: Right, exactly.

Demetri Kofinas: Which is where the real disaster struck. Right?

Charley Grant: Right. A niche auto player, you can make a profit and be a standalone business. You might not get much equity value for that though. I always thought Tesla would do fine if they stuck to making basically custom, [00:26:00] ultra-high end, sweet rides for a very wealthy select population, which is how they got started. There's a lot of rich people in Silicon Valley, you can make that kind of business work and keep the scale small enough where you can manage it. But Elon promised a million cars on the road by 2020 back in 2016 when they were putting out, 50000 a year.

Demetri Kofinas: And they still haven't sold 200000 as you said.

Charley Grant: In the US. They've sold more than 200000 [00:26:30] worldwide, but they were talking about ... I mean an exponential ramp in production, fast. You have to know how to do this because the auto business frankly is not a good business. It's very hard. It's capital intensive. You get your parts delivered upfront, it takes up a serious amount of work in capital. It's economically sensitive. Luxury car sales get hammered and every recession. It's been a long time since we've had one, but you [00:27:00] just don't sell high-end cars in that environment.

Demetri Kofinas: The manufacturing process also changed tremendously. Forget the automation component, right?

Charley Grant: Right.

Demetri Kofinas: Which I think there's something really enamoring about Tesla building all their cars here domestically and having their operations here. From what I understand, all their plants are here, correct?

Charley Grant: Yes.

Demetri Kofinas: But the thing that I've discovered in delving into this a bit is just how much the car industry has changed over the last couple of decades and the role of suppliers in this process [00:27:30] and that they actually have much higher price-earnings ratios for their stocks than the actual-

Charley Grant: Than the OEMs.

Demetri Kofinas: - than the OEMs. That's a huge issue too because that's networks and business development and relationships.

Charley Grant: Yes. Just look at how the auto stocks have done in this roaring bull market over the last eight years. The Volkswagens of the world. It's been great conditions to sell cars. Easy credit has helped, auto sales in the US word record-breaking paces year after year and the market gave [00:28:00] GM six, seven times earnings on the multiple. Ford the same thing and Toyota maybe eight or nine, but nothing too different, and I think that's basically right. I think the market has a right with that.

This is a very hard business and a lot of things go wrong sometimes beyond your control and its profits are minimal and everything has to go just right to make things work. And the world's most efficient plants. Something like a few minutes of downtime, [00:28:30] unscheduled in a year can make the whole operation unprofitable. Everything needs to be just so. And you can't just decide you're going to learn how to do that. There's one of the reasons why we haven't really had an meaningful auto startup in the last 50 years that has lasted.

Demetri Kofinas: This also brings back something else you said, which is that the public has operated ... I think investor have operated under the assumption that the [00:29:00] skills that tesla is acquiring and the brand it's building that's purely electric, are going to outweigh the legacy knowledge that comes from being a car manufacturer. But what I've discovered in my reading of what you're saying it sounds like, is that actually what's far more important still is all the other stuff and not, let's say the battery, which has been for example, it's a big thing.

Charley Grant: It's much more than just design.

Demetri Kofinas: Right? Exactly. That in fact, all the know-how that comes with building a car still vastly more [00:29:30] important than any other part of this business.

Charley Grant: And it's not just a matter of intelligence or anything like this. Elon Musk can land a rocket ship on a barge and you what? I can't that.

Demetri Kofinas: And that's a big part of this also.

Charley Grant: [crosstalk 00:29:43] hey, have you landed a rocket on a barge and you know what? I say you got me there. I have not. It's not like he's not a smart guy or something, but this is specialized knowledge that you can't just substitute for with something else. And that is what the bulls have missed here.

Demetri Kofinas: Well that's also what's so cool about this story. [00:30:00] Putting aside all the financial stuff, putting aside all the potatoes. It's the fact that Elon musk captures the wildest aspirations of this bull market. And also I think this particular

iteration of a bull market at this particular point in our evolution technology, and the innovations that are happening in technology, the public is becoming increasingly aware of things that would otherwise seem to be extremely up to subjects. Artificial intelligence, [00:30:30] machine learning, advances in healthcare, in biotechnology, synthetic biology, all these things.

The fact that this guy has a space company ... Like you said, he is launching rockets into space. Launching his car into space by the way, which I think is ...

Charley Grant: That might've been a waste of money but ...

Demetri Kofinas: That's also really fascinating, right? He launched a roadster into space. I want to ask you something, and I don't mean this ... I'll put it in a [00:31:00] noncontroversial way. People like lots, for example, Bob Lutz of a former vice chair of GM, right?

Charley Grant: Yes.

Demetri Kofinas: Who has called ... I think it's him or maybe it was someone else called it a Ponzi scheme. Some people have called it a Ponzi scheme. I thought that was weird for someone to call Tesla a Ponzi scheme, but when I looked into it a little deeper, let's say the bear case, if you were to make a bare case, it's not a traditional Ponzi scheme, but you could say that one of the features of Tesla which is so unique is [00:31:30] that Elon manages to diffuse anxieties or concerns about, let's say a potentially failing business or potentially failing project by not creating a new business, but creating the prospect of a new business, whether it is high-speed tunnels, whether it's semi-trucks, whether it is ... He even talked about some kind of electric plane, all this stuff.

Charley Grant: The hyperloop, New York to Washington in 20 minutes.

Demetri Kofinas: He just comes up with these-

Charley Grant: It sounds nice but I'm skeptical on [00:32:00] that one.

Demetri Kofinas: But it's a fascinating thing though, right? Because just to bring it back to this, to get away from the meat and potatoes and just on this aspirational quality. It's really astounding how far regardless of what the fate of Tesla is or if people agree with you or don't agree with you, no one can deny that Elon is a tremendous showman and he's managed to use that to great effect. In covering him and in covering the story, have you ever found anyone like that? I must say when I thought [00:32:30] about it, I certainly didn't think that Steve Jobs qualified. I thought you'd have to go to Walt Disney or P.T. Barnum. I couldn't think of anyone comparable within the last sort of, Boom.

Charley Grant: Well, just to look at the Gallup polls of most popular Americans. Okay, Elon Musk is from South Africa, but he was included in this poll. He was in the top five. I saw this. This came out maybe a few months ago and Elon was one of the most popular Americans

and I got to tell you, there were no other [00:33:00] business CEOs anywhere close on that list.

It's crazy how people truly idolized him in a way that's unique. I mean, no other company has that. That has been part of the reason why Tesla has reached such heights. And I also think that is part of the reason that they're getting into trouble now.

Demetri Kofinas: Did you see the interview that, what's his name? One of the writers for interstellar did with Elon at south by southwest?

Charley Grant: I read about it, I didn't watch it.

Demetri Kofinas: You had to really [00:33:30] watch it, but it's not different than a lot of other ones, but it was really funny because this guy sitting there asking him, these really esoteric questions about existential risks to humanity or things that I talk about on the show. Interesting things about, the problem with designing utility function for AI and whatever. Global warming, whatever it is, these existential risks. And Elon sitting there with his flight jacket looks like he just got off of a spaceship and he's giving these answers. But the reality is he's also the CEO of [00:34:00] these different companies.

Charley Grant: And he's not at the auto plant while this is going on.

Demetri Kofinas: Right.

Charley Grant: He's at south by southwest, he was at the Oscars, he's in Australia with Amber Heard. If you're running a private company, then you should do it your way but public companies, I think you should be really sure there are no problems going on in your own backyard when you're making appearances like that. And as we've seen in the last few weeks, definitely not all is well at Tesla.

Demetri Kofinas: And the thing is, I totally agree with that. [00:34:30] Again, for me personally, I want a guy like Elon to succeed. I love what he's done with space travel. I love the audacity, but at the end of the day, you can only get so many free passes. What it seems like to me is that ... Where we're at with Tesla and why I wanted to bring you in here to talk about it today, given what's been happening most recently, is that it feels like unlike the other times, it feels like this time something is really breaking. And it's breaking also because we may be at a point where the tide is coming [00:35:00] in or going out as I said.

Charley Grant: We got off a bit of a tangent there from the SolarCity acquisition, but I want to come back to that, that Tesla, what they always had before was a pretty clean balance sheets. So the profits looked dopey, they were never going to make any money. And I also thought well, the stock could go down a lot, but there wasn't much debt on the balance sheet. You could always issue equity and refigure things out. Those companies can definitely [00:35:30] experience sharp declines, but as long as you keep your debt burden to a dull roar, you can survive a lot of things.

But what happened with SolarCity when Tesla assumed that their debt went from maybe 2 billion most, of it was convertible bonds, so they wouldn't even necessarily owe the principal back, now it's more like 10 billion. And that is a really scary thing if you're a production if you keep losing money the way you always have.

We've seen that Tesla issued \$1.7 [00:36:00] billion bond last August to help finance the model three. And that bond got downgraded by Moody's after one interest payment. And that bond is trading at 86, 87 cents on the dollar, less than a year after being issued. They spent all the proceeds already on their cash burn and now what? So that's really alarming because they still don't make a profit. [00:36:30] We don't have first-quarter numbers, but I strongly suspect we'll see more sharp losses. And when you have this debt, it means the clock is ticking. You can't just say Elon is going to figure it out one day, he needs to figure it out right now.

Demetri Kofinas: At it's ticking in a rising interest rate environment and also in the certainty of the time domain, which is we don't know what's going to happen tomorrow. We don't know what's going to happen to liquidity.

Charley Grant: That's right. And they've put themselves in this position where even if they clean up their manufacturing problems, handle this recall [00:37:00] that was announced on Thursday.

Demetri Kofinas: 123000 model S's, right?

Charley Grant: Yes. And the supplier is going to pay for the replacement parts, but it's still going to cost, Tesla money, labor is not free. If they figure those things out, you mentioned rising rates. Some things that are ... They've exposed themselves to factors that are not even within their control here. Living at the pleasure of the capital markets. Well it's been a long time since this happened, but capital markets do close up sometimes without warning. [00:37:30] If that happens, this company is toast.

Demetri Kofinas: How does this end?

Charley Grant: How does this end?

Demetri Kofinas: You're not an oracle, but-

Charley Grant: I'm really not, let's make that clear to the audience.

Demetri Kofinas: None of are, but I'm sure you've imagined ways in which it might end. What are some of those that you've envisioned?

Charley Grant: Well, I think they can hang on for a while. I mean the stock has been going down sharply for a few weeks now. We've seen [00:38:00] that before and had sharp rebounds. Basically, Moody's said when they downgraded that debt last week that they

need to raise \$2 billion in the near term. They could do that in the equity market possibly. I think the debt market is a non-starter given the way the last bond situation has gone.

Demetri Kofinas: You're saying issue more equity?

Charley Grant: Yes, but now the currency is worth a lot less than it was six months ago when they were actually in much better shape when the model three [00:38:30] was this vision instead of this actual product that's causing significant losses and a lot of production headaches. Tesla has over promised and under delivered.

Elon Musk said in 2016 they were going to build 100000 model 3s in the second half of 2017 and they built 3000, something like that. 2000 and he said 100 to 200000. You can't in [00:39:00] the public markets, even a guy that everyone wants to believe in like Elon Musk, you can't keep pulling stunts like that. Eventually, people stop believing you. If people have lost faith in him, it could get very ugly very quickly. I don't think people have totally lost faith in him yet. I think even if he can't raise enough equity, the world will still wash in liquidity. You can go to South Bank, you can go to Ten Cent and there are theoretical options out there, but he needs to find a new stream [00:39:30] of money and he needs to find it soon. Otherwise, the stock is in serious trouble.

Demetri Kofinas: But what's challenging for me is I want to find the way in which a bull would rationalize this. I can't find that case. In other cases where a company is impaired and it's running a very high risk of bankruptcy, I can still find in the timeline that you're laying out and others have laid out that it can go on for much longer. I can find a way to rationalize that argument. I still haven't [00:40:00] come across one that like you mentioned, faith. I mean, it's not clear to me based on everything that Elon has said, the companies put out and the financials what that case would be. I don't see. It just seems to me that it's so divorced from reality.

Charley Grant: Well, one option is, bankruptcy is a dirty word but when you file for bankruptcy, you can reorganize the company, reset the debt levels. You can reset the capital structure in a way that makes sense [00:40:30] and start fresh and I think operationally that would be perfect. I certainly would be much less bearish on the outfit if they got a clean start with a new balance sheet. Of course, there's a small little, hold up with that which is you have to wipe out the current equity holders and that's obviously not something that can happen without significant angst.

Demetri Kofinas: What about finding a buyer? Is that even realistic?

Charley Grant: Not with these valuations. I mean maybe Space X, maybe Elon's ...

Demetri Kofinas: Not at these valuations. [00:41:00] Not right now. But let's say we get to a place where its price becomes attractive. What a company like let's say apple, which has supposed to be doing some work in autonomous driving and has a proclivity to associated software with its hardware, would they be interested in possibly buying a

company like this in order to compete with let's say a google or an uber or whatever. Some of this other tech companies that are providing the software solution?

Charley Grant: Never say never. That could happen. These companies are secretive about their self-driving programs. We know Apple's working on one, [00:41:30] but we really don't know much else in the general public. There could be a buyer out there, but here's another reason to wonder whether that could really happen. What if the self-driving thing is kind of just a fad? We saw that uber accident last week.

I think regulators have been in all these states. Self-Driving has been something to welcome, something to be a leader in, but as you know regulators can be quite fickle about this sort of thing. You saw the Arizona governor turn on [00:42:00] Uber sharply in a matter of 72 hours. It went from you're welcome in my state to well, maybe not. This business is very exciting and valued highly and has captured people's imaginations, but there's no guarantee it's going to pan out.

Demetri Kofinas: Well, I actually think that ... It's a really good point you bring up. I actually think generally speaking, we may be on the verge of a rise in regulations and increase in regulations across a number of industries. We might see it in the cryptocurrency [00:42:30] market and see it here as well with autonomous driving vehicles, especially if we have a turn in global equity markets and people lose a lot of money. People will start asking for the regulations. Same thing with autonomous driving vehicles and accidents.

Charley Grant: I mean the Tesla brand is obviously worth something and something meaningful, but that is ...

Demetri Kofinas: At the right price.

Charley Grant: Yes, and honestly that's the thing that if Tesla went bankrupt, you could buy that brand for really not much money and it would be a fantastic deal for a buyer, but that's [00:43:00] not a reason to holding on to this because [crosstalk 00:43:03] Someone's going to buy it. Tesla's plant, the Gigafactory is new, but not a whole lot really goes on there yet. It's not finished. The main plant Tesla got in California, was an old plan from the 1980's that previous owners had abandoned. They didn't want it.

These assets are not necessarily ... There's nothing wrong with them per se, but it's not [00:43:30] something that people are going to fall over themselves to have at any price in the industry. Wall Street will always follow themselves to have the hot stock at any price but ...

Demetri Kofinas: In general it just seems that they've bitten off much more than they can chew.

Charley Grant: Absolutely.

Demetri Kofinas: Charlie, I want to thank you for coming on and I also want to ask you, if people want to follow you, you write the Wall Street Journal, what industries do you cover? How can they find your stuff? And how do they follow you on twitter whereas I said you are a prolific twitter?

Charley Grant: Twitter handle is C-grant-W-S-J. You can find our stuff [00:44:00] on the hurt on the street page that runs in the back of the business and finance section in print and on the market section of the Wall Street Journal online on wsj.com. If you want to send me a note about how much you liked my article or much more likely how terrible it was-

Demetri Kofinas: Or what a terrible person you are.

Charley Grant: - or what a terrible person I am. I read it. I don't always get back to you, but I read it. My email is published in the online articles. You can find it there.

Demetri Kofinas: Alright mate, Charlie it was great having you on the showman.

Charley Grant: Thanks [00:44:30] for having me anytime.

Demetri Kofinas: And that was my market forces segment with Charlie Grant. I want to thank Charlie for being on the program. Today's episode was produced by me and edited by Stylianos Nicolaou. For more episodes, you can check out our website at HiddenForces.io. Follow us on Twitter, Facebook, and Instagram at @hiddenforcespod or send me an email. [00:45:00] Thanks for listening. See you next week.