TESLA equity options TSLA S

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by carbone959

			2019	2020
Price:	352.17	EPS	0	0
Shares Out. (in M):	180	P/E	0	0
Market Cap (in $M):	63	P/FCF	0	0
Net Debt (in $M):	0	EBIT	0	0
TEV ($):	0	TEV/EBIT	0	0
Borrow Cost:	General Collateral			

Description

I used to be short Tesla. Still hate Musk, but would like to present a completely different take...

The world has heard the Tesla bulls loud and clear, and the Tesla bears loud and clear. Today I am proposing a third way: be neutral: make money from all the noise by opportunistically selling expensive puts and calls. Over the past six years, this is the trade that has worked and I believe it will continue to work. It will be up to the reader to choose their desired expiries and strike prices. This write-up will focus on explaining why I believe this is the right way.

Background

Tesla is a highly-followed story, crazier than any other. The things we see with this stock are simply unbelievable compared to what we've seen before; the company is led by a guy who should be sweeping the floors at best and he's nutty, though smart PR-wise. I acknowledge that there are VIC members who like him and/or Tesla - these are members that have submitted good write-ups in the past so they're not stupid. What this means is that this isn't about intelligence. It's religion/emotion. The bulls - in my view of course - fall for a narrative that is flawed in the same way that certain great investors fell, for instance, for Valeant. It happens.

But either way, investing successfully is not about loving/hating a CEO or company, it's about making money, finding opportunities to outperform by doing something that is different and superior to what others are doing. The way I view Tesla is that there is actually a dual consensus trade. There is a large group of people that form a strong bullish consensus (including not only those who follow every move Musk/Tesla news item but also people in the general population who "support what Tesla is doing", or are "long tech", "long growth" etc' etc') and then there's a second group that forms an equally large consensus (this time a bearish consensus) and includes many, many smart people in finance, autos, tech, fixed income and others from around the world who had what is known as their 'realization' moment, where they realized that Elon Musk is actually a con man. Now, while the two groups violently oppose each other's viewpoint, there is a lot that they have in common:

- they are indistinguishable in that they are obsessed with Tesla/Musk

- they are indistinguishable in that for many of them, the TSLA position is among the largest in their portfolio.

- they are indistinguishable in that they are very sure that the stock will go in the direction they think and that it will do so soon enough to warrant the large position

- they are indistinguishable in that they believe TSLA should be front and center in the news and that government & powerful corporations are biased in favor of the other side.

- they are indistinguishable in that they get the other side angry, pouring more fuel on the fire. This has resulted in a large blog/YouTube following on the bull side and a large Twitter community on the bear side ($TSLAQ).

Together, they form the 2-part consensus belief of "Tesla will go very far in the direction I want it to.'' The contrarian view is "Tesla will be range-bound".

These two groups, together with Musk himself, have led the stock to trade in a way that is not comparable to anything else, not fully understandable by any diligent investor, and the company's options therefore trade at generous premiums. The stock has fluctuated between $200-$350 over six years despite a ton of news that should move the stock sharply. I believe it will stay roughly in that range and even if it exits that range, it will find a new range to comfortably trade at for another long while. I will expand on why I think each side is wrong that a move toward their target price is just around the corner.

The Bulls

So debunking the bullish case is easy; let's start with that. Tesla is an auto manufacturer that pretends to do other things but does not (it does a tiny bit, and not even profitably). It has 3 car models: 2 that are dying, 1 that is not really growing anymore. A 4th model is coming but it will probably cannibalize the 3rd. The company has massive operational/managerial problems and given that this is a low-margin business vulnerable to economic downturns, in an industry where so many have gone bankrupt before, it very very clearly does not deserve to trade at the current multiple. A target price of $4000 or even $400 makes no sense based on fundamentals. Its peers make better cars, are coming out with EVs, and to invest based on a magical beliefs like Ark is not serious. In Q3 revenues even shrunk. More importantly, the situation simply has so much hair on it (hair that isn't reflected in the price) that any responsible, diligent investor, should not go long this thing at all. We've had TSLA long write-ups here on VIC. I don't mean to offend anyone who is long but I honestly do not see how this can even remotely be described as a "value investment". If you read Warren Buffett's letters, this is 180 degrees from what he prescribes. Enough said.

The Bears

Ok...let's roll up the sleeves.

For many years I didn't follow TSLA. All I knew about TSLA was: auto-company trading above peer-multiples due to projected growth rate; well-known founder called Elon Musk, considered smart, entrepreneurial. I decided to stay away because I don't short growth based solely on valuation.

In early 2018, a series of interviews + research led to my 'realization'. Now armed with the knowledge that Musk is a con-man, and impressed with the arguments about the fading tax credit and the pipeline of competing EVs, I was interested. After the Moody's downgrade + AutoPilot accident in the same week, I thought "ok I'm in" and became a Tesla short. Soon-after I discovered this whole Twitter thing. The community of Tesla shorts includes VERY smart and diligent people, and more importantly, people who are simply wonderful. I was short in various ways… switched around instruments over time.. but exited on the Friday following Q3 earnings. 48 hours later I had what I now call the "Level 2 Tesla Realization" – that's when you realize this write-up's very thesis: that what you thought was obviously a catalyst for the Tesla to go sharply lower, is actually not. It's not your fault. Elon Musk is a very, very strong guy when he's up against a wall. He will do anything to survive, he will not give up. All day every day he thinks about how to shape his image and that of Tesla. And honestly it makes sense that it's expensive to be a TSLA short. All along I had this inner feeling that given this is such a big story, it can't possibly be simple. But I repressed these feelings because the facts underlying the Tesla bear case are incredibly compelling. Unfortunately, as compelling as they are, there's a lack a catalysts.

This lack of catalysts is the main thing I want to discuss. Now let's REALLY roll up the sleeves:

This whole investing in stocks thing is very simple. You have a description and a catalyst. In a long trade, the catalyst in most cases isn't too essential because: (i) management almost always wants the stock to rise and if it doesn't, activist investors may get it to rise eventually (ii) Wall Street survives better with a bullish bias (iii) if the company throws off actual cash flows and/or returns capital, you own an asset that is giving something. On the short side it's different: you're paying to carry the position, Wall Street doesn't help you and management, save for a few exceptions, wants the stock to go up. And every day that your short didn't reach its target price is another day for management to do something that reduces the probability of that ever taking place. And if you're using puts, time is your enemy directly. In other words, the catalysts have a decreasing chance of occurring as time advances and you lose in two ways: the probability of your best-case scenario declines AND the time frame for your trade lengthens. When you're long it's not like that because as time advances, the probability of someone getting angry enough about the undervaluation rises, and so the probability of catalysts occurring rises with time So with every passing day you're closer to your desired outcome, not to mention that the company keeps creating value with every passing day so you're being paid to wait.

All this to say that for shorting, catalysts are a component of the thesis, not just a thing on the side.

And if you look at Tesla over time, what you realize is that the catalysts are falling on their face. They either don't occur, or they do occur but Mr. Market continues its blank stare. Elon Musk faked a management buyout at $420 a share. Blank stare. The SEC first got aggressive, then he settled, then he violated a court order, got taken back to court and essentially won in what was a truly embarrassing moment for America. Now for anyone who witnessed it, this fake buyout was a big deal! When the scandal arose, I thought for sure this is the end of Elon Musk's reputation (it hurt his reputation a bit…but not enough) but today the stock trades at the same price. Yet throughout the ordeal most bears didn't pause long enough to think "maybe we're wasting our time". Instead it was all about Q1 numbers. And yes, Q1 deliveries were horrible but deliveries came back stronger in Q2/Q3. Oh, and there was a stretch of time in May where TSLA basically was on the brink of bankruptcy but Musk survived that by raising capital and the bears, again (I'm guilty of this too) kept going instead of thinking "maybe we're wasting our time". Same with Q2/Q3 results. After the company announced Q3 and the shares rose sharply due to a combination of lies on the 8-K, many bears adopted the same attitude: "Oh just wait until the 10-Q come out" or "The Solar City depositions" that was due the following Friday. Well, guess what? These things did come out and these depositions expose Musk, more than ever, as a complete joke – perhaps worse than Adam Neumann. But the shares are YET HIGHER! Tesla bears have a massive catalyst crisis.

How to Understand TSLA Stock Price

I've pointed out many times in the past that there's no easy way to understand why TSLA fluctuates between $200-$350 for years and that it's important to find the reasons. Answer this for me: why is its range not $2000-$3500? Why not $20-$35? After all, in these ranges it would still be overvalued! So why $200-$350? I think the best explanation I've heard is that because so few institutions want this stock, it is more unstable, with many more retail longs plus a ton of shorts who have the potential to cover, plus all kinds of algorithmic trading, swing trading etc'. What's for sure is valuation-wise, it cannot be understood – not even as an overvalued growth story, which is the topic of the next section.

The "Broken Growth Story" Claim/Hope

So there's been this thesis that Tesla is a broken growth story and the stock will decline when the market discovers that. First it was supposed to happen in Q1. Then it was Q2-Q3. Well, in Q3 sales were down 8%! The growth is gone yet the stock rose $70. In fact it's even nuttier: over several months bears have correctly pointed out that the Model S/X sales are down so much that they will have to be discontinued. Well, on the Q3 call Musk simply stated away these models in one sentence. He said they will still stay there for "sentimental" reasons but are essentially in the past. And the stock rose $70!

Let's analyze what a growth story is. Typically, stocks growing at nominal GDP with average ROIC characteristics trade for 10-20x, depending on the overall market's valuation levels. A company growing faster might trade for more, often at a 25-35x P/E. In that scenario, the E grows at a faster than average rate and the P grows at the same faster than average rate, and so the P/E stays constant. ...Until the growth stops, that is. One day a disappointing report hits the tape and the multiple compresses hard. The E still rises, but just a little, too little, so the P/E declines to 10-20x and so the P declines proportionately. This is the definition of a broken growth story.

Where would Tesla fit in such a story? Nowhere. Tesla's top line isn't growing! Therefore its stock price today of $300 must be due to something other than being a "growth story". Now, I understand that some sell-side analysts and Cathy Wood, and many bulls, project high growth of unit sales in some undefined future, much like a mine stock carries a premium for future yield, but there's clearly something more 'inspiring' holding up an auto stock like this, and we all know what it is: TSLA has a "genius premium" built in. If Elon Musk went away tomorrow, the stock would instantly re-rate in line with automaker peers. It's obvious. The company would no longer do anything in tech/energy and would shortly reveal itself as a sub-par auto manufacturer with various tough issues to solve. Look at how Musk simply stated away the Model S/X. Just as he did that, one day he might state away the entire car business. Remember when Musk said "we don't feel reservations is a good measure of our performance"? The stock is trading at the same price today vs. the day he said that! The next step will be "we don't feel deliveries is a good measure". He's gonna say Tesla is too busy working on the next car/tech which is going to be so much better, and the bulls will eat it up and call the bears short-sighted. The bears will say "oh ya but where's the cap-ex for your new project?" but no one cares unfortunately. As long as Tesla can raise capital and survive, it can argue that it has a team efficiently working on the next big thing. And I want further move toward the whole idea of telling stories + raising capital because it's important:

The Core of the "Tesla Neutral" Thesis

Musk has become a master of narrative control. Look all around you! People around this planet think that Elon Musk founded Tesla, founded PayPal, was the first one to land rockets, etc'. He controls the narrative and lies and the SEC doesn't punish him. No agency wants to be responsible for the downfall of TSLA, they just want to get there at the clean-up phase. Like Elon Musk, they too create narratives for the public to consume. Some reporters have done a magnificent job of calling Musk out but the list of such reporters isn't experiencing any growth. Consider how nicely Robyn Denholm was received recently on CNBC by Erin Burnett despite the fact that another CNBC employee, Lora Kolodny, is deeply critical of Musk. There are politics and other factors at play here. Musk will not fall as easily as bears think. And it's all because of one thing: in polite society you don't question someone who is trying to reduce CO2 emissions (i.e. "Tesla's mission") even if that someone ironically often had to power 'super'chargers with Diesel generators. Every bad thing is treated as an unfortunate slight imperfection.

Tesla's board is highly paid and conflicted. Musk owns lots of equity and wields tons of power. He controls the whole thing. Shareholders don't complain because they love him - they are utterly naive. This is a cult. And activists won't get involved at this valuation. So there is absolutely no stakeholder that wants to remove Musk from power. The only scenario where someone asks him to go is lenders in front of a judge. But we are dealing here with how/whether we will get to bankruptcy court in the first place.

Let's expand on Musk and debt-holders. If you're owed money by Tesla, your wish is that they'll keep raising equity capital and use it to delever and eventually pay you back or keep paying handsome interest; as long as they don't default it's all good. In order to raise capital at current equity valuations, success depends on Musk's lies and pumping, so debt-holders need Musk to stay and lie, not go. To be more precise, debt-holders will keep Musk so long as they believe capital can be raised more easily in his presence vs. his absence. And right now presence is better (e.g. the May 2019 raise) and as mentioned above, as long as Musk stays, he controls the narrative and keeps lying. And no agency punishes him. Wall Street is also very happy here: Wall Street's incentive is that the total EV of all potential clients is as large as possible because that maximizes their total addressable market. They have no reason to want a Tesla implosion.

So debt-holders, equity holders, Musk, and really everyone except shorts benefits from Musk staying in power. Yes, shareholders benefit too. Of course, it would be good if someone more competent was hired for operations in order to improve margins, but right now these capital raises are priority #1. The value as a going concern is less than the debt so if he leaves it's a zero. Also, because Musk himself is a shareholder and because he wouldn't want his empire/reputation to implode, his incentive, like any other shareholder, is to stay and keep trying to raise capital (i.e. lie and then raise capital).

So tell me, if the man stays in power, if the lies will continue, if no one does anything about it and if the bulls believe in fairy tales about solar roofs, what makes the Tesla bear case good? What exactly are its catalysts here?

Insurance premiums?

I thought that's a catalyst but Tesla is taking a loss on insurance now to keep the fantasy going. And as long as TSLA can raise capital they can offset that loss.

Model 3 sales declining?

Clearly not a catalyst. And if it gets worse he will say they're working on something more important.

Lawsuits and other revelations of misbehavior?

Solar City is really a pile of some of the most egregious behavior, yet the stock has not declined. It's Philidor x 10. There's more than Solar City: Montana Skeptic, Skabooshka, Christina Balan.. there are enough people out there who exposed many bad things about Musk and it has not dented the stock.

Fights with journalists?

He got into some beef with Charley Grant and Russ Mitchell. Normally, that's supposed to be huge. Still no reaction in the stock. Musk had his Jeff Skilling moment 17 times already and still nothing.

Service issues?

Too many consumers have chosen to put up with them.

There are so many more examples like this of failed catalysts.

Further Dangers to the Short Thesis

There are other potential dangers that shorts don't see now, and the most important one is a potential strategic deal with another automaker. Let's draw a scenario:

Elon Musk is obsessed with PR/image. So far we agree? Ok. Musk knows about all the service issues. They exist by design to conserve cash, but at some point they'll catch up to the company. What will Musk do? Survival instinct.

Imagine this: Tesla reaches out to a more experienced manufacturer and gives them a really generous margin for building the car, perhaps even suggesting improvements etc'. The price might rise as quality does but Tesla buyers will absorb that. They're part of a cult and will eat up overpriced 3s and Ys in any scenario. By the way, it's very important to distinguish between the S/X vs 3/Y. The S/X have been heavily discounted because the rich crowd is done with the novelty and is moving on to the Porsche and other EVs. But the clients for the 3/Y are not so much value-signaling rich people; they're more middle or upper-middle class who follow Musk blindly (until they no longer do).

The partner manufacturer says "sure Elon but we want control of X Y and Z" because they know Elon is difficult to work with. And, aware of the precarious state of TSLA, he will agree. He keeps the marketing. So now he keeps lying, he's still CEO, people still love him, the shares will surely rise due to the deal because all quality/issues will presumably be solved + "partnership", and the partner suffers no brand damage if things go south. The partner gets a nice margin, Tesla gets only a small percentage of the top line but who cares? They can raise more money thanks to all of this, so they stay afloat, and Elon stays in power and keeps lying. And the stock keeps its 'tech' and 'energy' premium.

A scenario like a partnership prolongs the story even more and it's not totally impossible. Also, while the company has not done this so far, they do have the potential to use their overvalued shares to make good acquisitions. This would further hurts the short thesis.

Summary

I can really go on and on. Tesla is an infinite subject as we all know. But I've learned one lesson long ago that I unfortunately ignored for Tesla: when people discuss every small detail of a company they're shorting, it means that there are a lot of interesting obscure things to discuss that are scandalous, which means the media is not talking about a scandal, which means management is hiding these things and not being called out on it. Yes, one day this will probably all end and some of the craziness will be revealed (in some stocks the bad stuff never makes it out actually) but how long it will take for TSLA + where the stock will be is a completely different thing. If, for so long, this has survived as an overvalued cult stock in the tens of billions of market cap with bonds trading in junk territory, it can survive many more years this way.

Most people's incentive is for Musk to stay, raise capital by lying, rinse, repeat. Rallies will be met with disappointments by the ignorant bulls, and setbacks will be met with rebounds thanks to Musk's survival skills. Sell options outside of the trading range, sit back and laugh at the ridiculousness of it all.

I do not hold a position with the issuer such as employment, directorship, or consultancy.

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Catalyst

[assuming we define 'catalyst' as the things that will keep TSLA range-bound]

- Company keeps having issues because it is wildly mismanaged
- Musk keep taking out bunnies from his hat to survive longer and society keeps giving him a pass

Messages

Subject Some people just want to see the world burn
Entry 11/17/2019 08:37 PM
Member HoneyBadger

EOM

Subject Appreciate The Commentary ...
Entry 11/17/2019 11:10 PM
Member bowd57

Hi, Carbone --

... and view, but not so sure about the implementation. FWIW, I rated this an 8/5.

1: You sure about this options thing? Are you actually putting this trade on? Selling options is theoretically, "I think implied vol is higher than realized vol will be." Do you actually think that? Like, "TLSA just going to hang around $350 for the next 3 months, so you can reap some heft premium"? Or are you really just advocating leaving emotions and crusades aside and swing trading the stock?

2: If it's about swing trading, and the range is $200-$350, and stock's at $352, maybe an unemotional, non-crusading short would be better than messing around with options?

Separately, "Imagine this: Tesla reaches out to a more experienced manufacturer and gives them a really generous margin for building the car, " The idea never occurred to me. Is that even possible?

For what very little it's worth -- and no need for anyone to respond! -- VW's investing Tesla's entries market cap and 2.5x it's sales into non-ICE over the next five years. I think Tesla gets crushed because, as far as I know, it's a competitive industry and Musk's bullshit machine is the only secret sauce they've got.

Yours,

Bowd

Subject Solar City Fraud and Self-Dealing
Entry 11/17/2019 11:21 PM
Member Kruger

Carbone, thank you for the excellent article. I disagree with you on one point. The securities fraud and self-dealing surrounding the acquisition of Solar City is epic and obvious to anyone who has read the many internal emails and other documents that have recently been made public. The timing is hard to judge, but this scandal will eventually force Elon Musk to resign from Tesla and will likely land him in jail. The extent of the fraud here is too obvious to be overlooked.

Aside from this possible catalyst, which could be years in the future, the trifecta of events that will eventually cause TSLA to go to zero are a combination of gradually increasing competition, a wicked recession following one of the longest expansions in history, and a nasty bear market in which money is hard to raise. The castle will crumble, but its going to take some time. Bears had better have proper risk control in place for a move to 600 should that become a reality in the meantime.

Subject Timing
Entry 11/19/2019 02:31 PM
Member tac007

Appreciate the idea.

I have 2 issues with this trade. The trade would have worked in the past 5 year or so. Are we biased to think that is why it would work in the future? Who is to say that TSLA does not go to $600. If this happens you lose 4x+ the premium. Also, in terms of timing, TSLA is above the $350 mark. It's risen extremely fast. If we put the trade now, it sounds quite risky. If the stock breaks resistance, you can get crushed, and if it goes back down to the $200 level, then you also get crushed.

I am curious to hear your thoughts on how to mitigate this.

Regards,

tac

Subject Sorry but disagree on need for catalyst
Entry 11/19/2019 07:32 PM
Member Biffins

"This whole investing in stocks thing is very simple. You have a description and a catalyst."

You don't necessarily need a catalyst. Sure it would be nice. That's called event-driven. If you're true value investing, you don't need and most of the times don't have a catalyst. The valuation itself is the catalyst and the timing is uncertain on when Mr. Market wakes up to the reality. And the fact that you'd like to have a catalyst on the short side is only relevant to the extent that the short is expensive to hold, otherwise it's not an issue. I've held shorts for many, many years without a catalyst.

I also think selling puts on Tesla is very dangerous. This stock can open down 40% and pierce straight through your strike in no time. It's not clear to me at all that the vol is cheap.