



Pinocchio Motors

Imagine if the sell-side had to recall every overly optimistic forecast 25th April 2016
Mike Newman



Picking on the spectacled fat kid with ginger hair

*¥370bn in
mkt cap
torched*

Here we go again. The story starved media gets its hooks into a has-been car maker with a mediocre presence and spinning it into the potential for multi-billion dollar fines. Mitsubishi Motors Corporation (MMC) admitted the falsification of fuel economy records. It is never good that a corporate admits to telling porky pies. To April 25, MMC has shed nearly ¥370bn from its market cap since the scandal broke.

*In MMC's
defence*

In MMC's defence, quoted fuel economy stats in any automakers brochures are always overly optimistic. The officially sanctioned tests are run on smooth tarmac in ideal conditions. So inflating already inflated numbers in the real world effectively makes no difference. However is this form of advertising any different to the Flab-blaster 1000 helping you lose belly fat or a shampoo that will make your hair silky smooth? Should research analysts be held accountable for every single earnings mistake found to be made through a lack of rigour and due process? One might even argue that in the dating game, interested parties inflate their qualities to such a degree that should the other party fall for it they could be sold goods that might not live up to expectations.

*Lies, more
lies*

*Class actions
in Japan*

Class actions in Japan will be promulgated in December 2016. There are no cases now. [The Consumer Court Special Procedure Act](#) ("The Act") will only allow qualified consumer organisations (not consumers) to sue against businesses. In many cases such consumer bodies have limited financial resources. Under the current Act certified (by the Prime Minister no less) consumer organisations can file for injunctive relief not damages. From the end of that year it might change but since 2007, 15 lawsuits for injunctive relief have been filed. Interestingly, the 2007 law says that consumer associations must notify any offender corporations to provide a window to fix the problem before engaging in any legal action.

*New law in
Dec 2016*



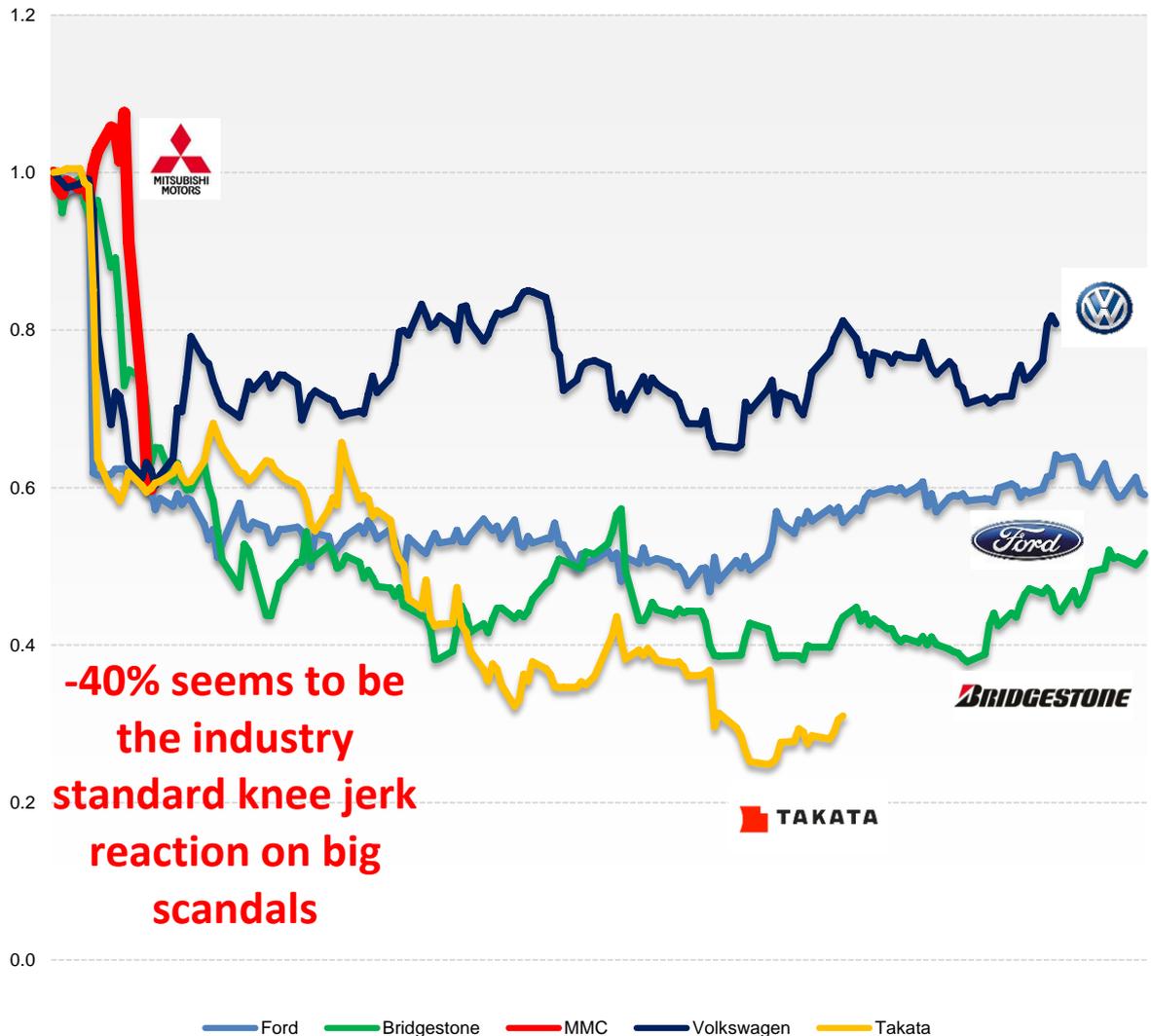
The deal with Nissan

Remind yourselves that this MMC's issue is a domestic situation so far. It is unclear whether foreign vehicles have been affected and if so, likely to be a minuscule percentage. Having a customer such as Nissan to assuage is perhaps the biggest problem. Losing this clearly 'generous' supply arrangement is a bigger long term risk as it potentially unravels the third party production business model MMC was forced into. MMC itself was a customer of this model outsourcing Pajero Mini production to Pininfarina not to mention the partnership with Volvo (Nedcar) in Holland.

How local courts have dealt justice before

The problem cars are domestic and as a result the 'local laws' will apply. To put a scale of fines on domestic companies we need to look at how other corporations have fared. Toshiba (6502)'s accounting scandals cost it ¥7.37bn (US\$70mn) for covering up around c.¥200bn. This surpassed the ¥1.6bn fine paid by IHI (7013) in 2008 for a similar crime amounting to ¥20bn. Toshiba's fine equated to 3% of the lie and IHI around 7.8%. Olympus' fine of ¥700mn was around 0.3% of the fraudulent takeovers of c. ¥200bn. MMC has not done 'fraudulent' accounting. It has inflated fuel economy stats on its cars by 10% which in reality takes us back to whatever was printed in the brochures was never going to be hit anyway.

Fig. 1 :Automotive Scandals & Relative Share Price Action immediately after



Source: Custom Products Research



We put together some share prices of corporates linked to automotive scandals to provide some perspective on how shares initially react over the ensuing 6 months.

40% is the industry standard for knee jerk scandal outbreak

It is clear that a 40% fall looks like the industry standard knee jerk reaction. Ford (F US) and Bridgestone (5108) shares reacted negatively to the Ford Explorer/Firestone rollover/tyre burst cases of 2000. 260 odd people died in the US. At the time many analysts tried to downplay the litigation aspect and consequent impact to Bridgestone. It was so under baked as to be unreal. The US loves a good class action and the shares responded took a while to take a beating. Ford also marked time in the initial phases until the matter became clearer. Takata (7312) has remained under pressure for its wilful misguidance of its customers. In Ford, Bridgestone & Takata's case, lives were put at risk. For VW & MMC, this is not the case. However punishments seem to be over-inflated.

As it is the Japanese domestic market that is under fire we can only suspect the MMC fine will be paltry compared to the 500,000 car buyback that VW is embarking upon. Let us not forget that one can be an insider trader in Japan and pay a fine of only [\\$700](#). Pretty light on.

Nissan's relationship with MMC – how to squeeze the lemon

Nissan will expect to be compensated somehow but if the production arrangements via MMC are viewed as long term beneficial to Nissan then perhaps MMC will be forced to accept even tougher terms on outsourced production in place of a fine. The juxtaposition of MMC is simple. Accept slimmer margins on future outsourced production or risk having to close plants and face the prospect of further restructuring. It is unlikely the government wants to see another round of layoffs. MMC employs around 30,000. Nissan can choose to bury MMC if it so chooses and indeed if it has the will to go to Osamu Suzuki and ask for similar terms which are probably unlikely it could but I suspect it won't.

Summary

Research analysts aren't lawyers

It is highly likely that research analysts will continue to espouse the legal damages aspect of the MMC fuel economy data scandal much like they didn't do at the time of the Bridgestone/Firestone scandal. Once again they will miss the point. Class actions in Japan are virtually non-existent and even if successful won't amount to much. The real issue here will likely revolve around how MMC is punished. For the domestic market, Toshiba tops the pops at \$70mn based on egregious financial manipulation. If MMC was fined the same \$70mn against the market cap drop of \$3.5bn implies a 98% over-reaction ceteris paribus. Of course Nissan will have a great leveraging point to squeeze MMC's already weakened position to sustain employment and hold onto a relationship that keeps what irrelevance they have left in the automotive industry alive. However is that likely to cost MMC another \$3.43bn in lost revenues and associated restructuring?

Pinocchio Motors MMC may be, but Carlos "Geppetto" Ghosn will likely shave the dead wood off and give one final chance for the Mitsubishi Motors management to dream of becoming a real car company.



Important Disclosures:

This material was prepared for you and is for your information and use only. This material should only be distributed to other members of that organization on a need to know basis and should not be distributed or disseminated to any other person or entity.

This material is for information purposes only and it should not be regarded as an offer to sell or as a solicitation of an offer to buy the securities or other instruments mentioned in it. This material is based on current public information that Custom Products Group Limited ("Custom Products") considers reliable, but we make no representation that it is accurate or complete, and it should not be relied on as such. No investment opinion or advice is provided, intended, or solicited. Custom Products offers no warranty, either expressed or implied, regarding the veracity of data or interpretations of data included in this report. This material is provided with the understanding that Custom Products is not acting in a fiduciary capacity. Opinions expressed herein reflect the opinion of Custom Products and are subject to change without notice.

The products mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors. The value of and the income produced by products may fluctuate, so that an investor may get back less than they invested. Value and income may be adversely affected by exchange rates, interest rates, or other factors. Past performance is not necessarily indicative of future results. If a product is income producing, part of the capital invested may be used to pay that income. © 2015 Custom

Contacts

Hong Kong

Simon Rigney

☎ +852-3958-2394 (HK)

☎ +81-3-5786-3712 (Tokyo)

✉ simon.rigney@custprd.com

Salt Lake City

Patrick Hansen

☎ +852-8191-6925 (HK)

☎ +1-801-230-4796 (SLC)

✉ patrick.hansen@custprd.com

Tokyo

Robert Rowland

☎ +81-3-5786-3711

✉ robert.rowland@custprd.com

Michael Newman

☎ +81-3-5786-3713

✉ michael.newman@custprd.com

Office Locations

Hong Kong

15/F Langham Place
8 Argyle Street
Mong Kok, Kowloon
Hong Kong S.A.R.

Tokyo

17/F Roppongi Hills North Tower
6-2-31 Roppongi,
Minato-ku, Tokyo
Japan 106-0032

Salt Lake City

299 South Main Street
Suite 1300
Salt Lake City, UT
United States, 84111