



Tesla

Tempting Expediciously Stupid Legal Action

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Would any auto OEM CEO actively look to introduce such a function?

Take a look at the picture above. Isn't looking at something in psychedelic colours distracting? I could go on for the entire report but your eyes probably took longer to read this far. This text at the very least is static not rolling. OK it is starting to annoy me. Sorry.

Is media success going to Musk's head?

Autopilot not 100% fool-proof

Do his lawyers understand automotive litigation?

Back to the picture. First, the driver is speeding at 70mph in a 65mph zone. Second, the 'psychedelic cowbell (rainbow) road' is constantly moving so it could be distracting. Third, the driver (one of many to post videos on YouTube) is using a smartphone behind the wheel to take a video of his/her supposedly Mario Kart function. So two laws have been broken on the back of a CEO actively promoting owners to try it. It should be of concern to shareholders that Musk is letting the potential success of the Model 3 go to his head and is using the current media spotlight to aggressively promote the Tesla brand in any way. Promotion is not a bad thing unless that advocacy potentially leads to danger. Now whether the Tesla's built in radar guided autopilot system could potentially prevent an accident is beside the point. These auto-braking functions are not 100% fool proof and were an accident to occur (especially one resulting in death) a driver could quickly point to the cowbell function as distracting him/her and put the blame back on Tesla and there is no right of reply if the CEO himself is promoting such optionality of his vehicle. To me it suggests that Musk is grossly underestimating potential legal pitfalls of the automotive industry and the dangers of class action lawsuits that have impacted brand image of major OEMs. Is Musk's team of legal experts somehow lost on the psychedelic cowbell road themselves to advise that such a mindless function which carries no perceivable benefit to safety, moreover putting owners in harm's way is somehow smart?



Elon Musk's Tweet of how to activate cowbell road



Source: Twitter

No way in the world would Toyota's CEO Akio Toyoda or Daimler's Chairman Dieter Zetsche actively promote such a function in Toyota or Mercedes Benz cars let alone any other OEM.

Elon Musk promotes the autopilot system saving a customer



3:34 p.m. - 17 Apr 2016

Source: Twitter

Autopilot functions in cars is not unique to Tesla. Most luxury cars carry some form of autopilot (automatic braking, lane assist, blind spot warning or radar guided cruise control systems). Even low end Japanese minicars carry automatic braking as standard. Nippon Ceramic (6929) provides sensor systems to a variety of OEMs to prevent low speed accidents.

Daihatsu Wake – Advanced Safety Vehicle (ASV) with auto-braking



Source: Company data

As we wrote in our April 12th report, [‘Tesla – Electric Shock in Waiting?’](#) “Tesla’s CEO Elon Musk is a marketing genius.” We meant it. The report also ran through 15 risks to consider as a new entrant into a business littered with players possessing multiple decades, some over 100 years of history. We wrote that experience, distribution, R&D, customer big data and so on were extremely big hurdles for Tesla to overcome. In the reverse, Tesla gave the industry a massive free-kick by

Even Japanese minicars have autopilot

The incumbents aren't asleep at the wheel

Developing EVs for decades



highlighting a potentially bigger market for luxurious EV than they had first thought. Up until that time, incumbent manufacturers had only put forward compact sized EVs (I referred to as snot-boxes) to cater to short city trips to the shopping mall and to do the school run. Automotive giants have been developing EVs for decades. Within most large OEMs there would be specialist teams that have been designing and developing. They won't be starting from scratch. They will be pretty much ready to go in several years should they require. Porsche has already thrown its hat in the ring.

Class action lawsuits – Auto companies are massive whales to ambulance chasers

Auto OEMs and harsh reality of class action lawsuits

Automotive OEMs have at times been raked over the coals by the regulator. Some problems have been through fate, others through deliberate cost cutting measures. Recall the [Ford Pinto](#) from the 1970s. The National Highway Traffic Safety Administration (NHTSA) ruled in 1977 that the Pinto's fuel system was defective and had been responsible for multiples deaths. The apparent design change to prevent such hazard was only \$11 and Ford Motor (F US) had weighed up the risk of up to 180 deaths was less than the cost of install. The jury awarded \$125mn in damages (which was later reduced).

Audi

Audi in the US was crushed for unintended acceleration issues in the 1980s. In 1985 the car maker shifted 75,000 cars but after a [60 Minutes](#) expose, the sales had trickled to 12,000 by 1991. It would take Audi almost two decades to see the 1985 unit numbers again. In 2012, Toyota ended up [paying \\$1.2bn to the US Justice Department](#) over an unintended acceleration case to avoid prosecution over supposed internal documents. 9.3 million Toyota vehicles were recalled.

Toyota

Ford & Bridgestone

In 2000, Ford was also mired in controversy along with Bridgestone when the latter's Firestone subsidiary was blamed by the OEM as responsible for a spate of rollovers causing multiple deaths due to their claim of defective tyres. In coming months Bridgestone's shares fell 60%. Ford shares declined almost 50% during the same period.

Markets price quickly even if litigation takes much longer

While the true outcomes of legal disputes may take years or decades, markets by their very nature will look to price risk and assume millions, possible billions in damages. If Tesla's cowbell road function gets linked to any accidents then a stock priced on the multiples it is could be at risk. Tesla's PBR is currently at 31x.

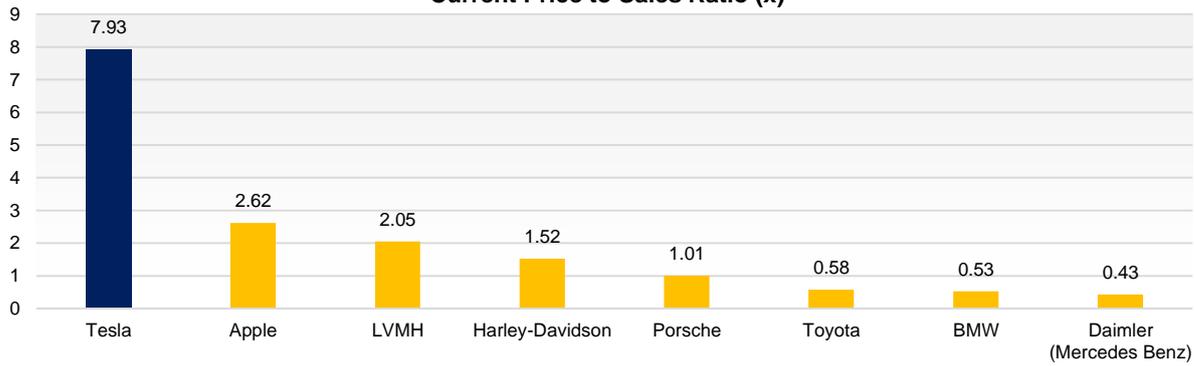
Tesla valuation at risk of mean reversion?

Let's not forget mean reversion risks

Tesla has a global market share of less than 0.01%. It would need to grow 160x to match Toyota Motor (7203) for market share based on 2015 production volume. Having said that Toyota has 66x more revenue than Tesla yet only trades at 4.5x its market capitalisation, not to mention having record operating margins over 10% in the most recent fiscal year. Even stacking Tesla on a price-to-sales ratio (as it makes no profits yet) would make it 18x more expensive than Daimler (DAI) the maker of Mercedes-Benz which is in probably one of its healthiest product cycles for decades. 3x more expensive than Apple. Markets will be the ultimate judge and jury of what is a fair price for Tesla but it is always worth keeping any potential risks in mind.



Current Price to Sales Ratio (x)



Source: Company Data, Custom Products Research

It isn't deliberate but naïve

We are not suggesting that Tesla has acted in anyway shape or form to deliberately cause distraction but in the quest to highlight the 'software capabilities' of the vehicle (arguably to draw attention away from the Tesla Model X recall) have inadvertently done so. It is a needless feature made worse by the fact that CEO Musk has highlighted more tomfoolery awaits.

First to file legal action could be owners

While psychedelic dashboards may appeal to owners such that they can brag about Tesla's innovative functionality let there be no doubt that any accidents, injury or deaths caused by such a distraction will see these owners or their families to be the first to file legal action. Such is the way with litigious societies that the courts seem to rule in favour of those led astray by evil corporations. The danger with group think is that the same people that blindly applaud everything that Tesla does will quickly about face if it is fashionable to bash it were any obvious danger finally be seen as reckless. Twitter, of which Musk is a fan, can be amongst the worst for nameless attacks as Stephen Fry pointed out as he deactivated his account of nearly 12 million followers,

Stephen Fry put the face of Twitter on trial

"Oh goodness, what fun twitter was in the early days, a secret bathing-pool in a magical glade in an enchanted forest. It was glorious 'to turn as swimmers into cleanness leaping.' We frolicked and water-bombed and sometimes, in the moonlight, skinny-dipped. We chattered and laughed and put the world to rights and shared thoughts sacred, silly and profane. But now the pool is stagnant. It is frothy with scum, clogged with weeds and littered with broken glass, sharp rocks and slimy rubbish. If you don't watch yourself, with every move you'll end up being gashed, broken, bruised or contused. Even if you negotiate the sharp rocks you'll soon feel that too many people have peed in the pool for you to want to swim there anymore. The fun is over. To leave that metaphor, let us grieve at what Twitter has become. A stalking ground for the sanctimoniously self-righteous who love to second-guess, to leap to conclusions and be offended – worse, to be offended on behalf of others they do not even know. It's as nasty and unwholesome a characteristic as can be imagined. It doesn't matter whether they think they're defending women, men, transgender people, Muslims, humanists...the ghastliness is absolutely the same."

Getting real with orders folks

Order realities

We would also like to correct our statement of \$1,000 deposits in our previous Tesla report. It turns out that deposits are fully refundable which only makes the ability to forecast 'real demand' that much trickier. People can order up to two cars. It is unclear how many of the c.400,000 orders made to date have been multiple reservations. Many who have placed orders early on for the Model 3 that may be looking to trade them will find the reservations are non-transferrable except on the prior written approval of Tesla. However there would be nothing stopping early reservation



holders from selling their cars immediately after they bought from the dealer to desperate buyers wishing to get their hands on a Model 3 for a premium.

So much of today's world is narcissistic. To say one has a Tesla Model 3 on order exudes a certain hip image. I am sure some will laud their early-adopter intelligence. However I'm guessing that if one has to wait 3 years until his/her Tesla Model 3 arrives (by which time multiple reviews will have been written and reliability will be open to all) cancellations could accelerate intentionally. It puts the shoe back on the other foot to what levels Tesla intends to produce at, which we ran through in detail in our previous report. For industries with high fixed costs, finessing production rates to be sustainable and profitable is both an art and a science. If Tesla produces too few, it risks order cancellations from impatient reservation holders and if it produces too many then it risks excess capacity should orders dry up or long term demand fails to grow much beyond 400,000 units.

Ordering a Tesla is more about bragging rights for narcissists

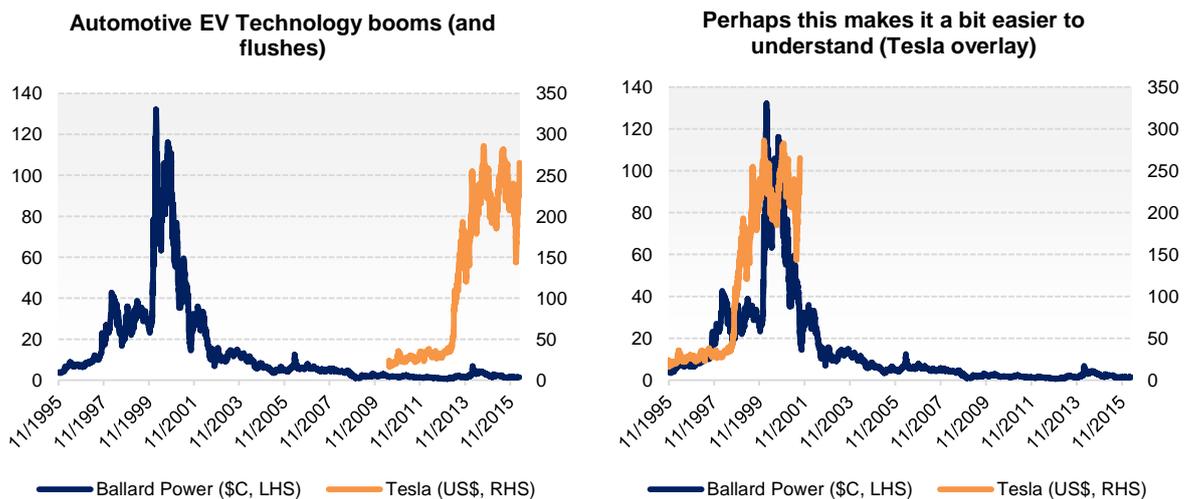
The graveyard of dead auto OEMs

The automotive industry is littered with the carcasses of companies that got the market wrong. Saturn anyone? Saab anyone? Tesla has done well so far but the game can change quickly especially now that automotive giants have been awakened.

So called 'disruptors' often show lots of promise but haven't always fared well

Reminder of overexcited markets

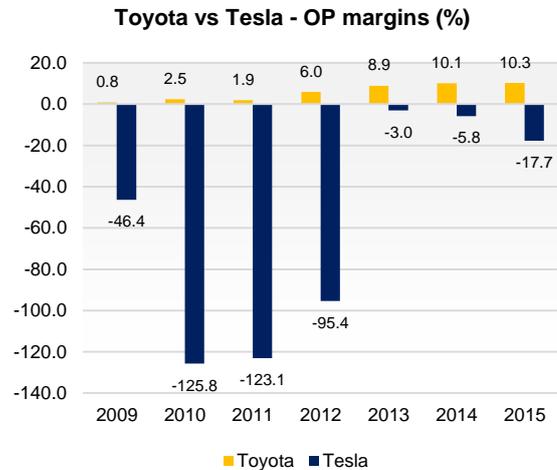
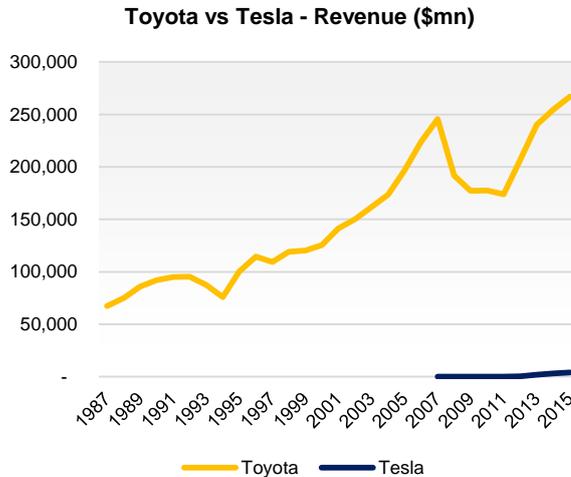
Ballard Power (BLD CN) was expected to revolutionise fuel cell EVs (FCEV). The technology was expected to shape the future of the car industry. The hype back in the late 1990s was huge as many thought EVs would be over 10% of the total market by 2010. More than regale the story of Ballard Power perhaps the share price explains it much better. Commercialisation is always the key. Yes, Tesla has commercialised its products but competitors must see the segment as a gap in their own market and will look to fill it. Spoiling the market for Tesla is a strategy in and of itself. Even if it is loss making, car makers will entertain such moves and have far broader infrastructure and existing platforms to develop new product.



Source: Bloomberg, Custom Products Research



The following charts show the vastly differing levels of revenue and profitability.



Source: Custom Products Research, Bloomberg

Summary

We do not fault Tesla for one second for its pioneering work in EVs. They have attractive product and have a unique selling property. Elon Musk is an incredible negotiator and marketer. The products appear to be selling well and filling a niche in the luxury end of the EV market. Ultimately Tesla will be fighting amongst the automotive giants which have enormous resources, experience, distribution, and existing platforms to respond. Change in the automotive world rarely happens overnight but when it does the impacts are immense. Much like we have seen in major military battles superior weapons, tactics and strategy have often been undone by the sheer weight of numbers, changes in weather and retaliation when the enemy least expects it. Global auto makers have seen what Tesla has done and unlike the huge market share of Apple, Tesla will unlikely ever achieve those figures in the automotive world despite some investors having a blind belief that Tesla (currently less than 0.1% market share) will somehow achieve similar market greatness.

Ultimately the consumer will be the judge of Tesla's success or failure. However by trying to appeal to the inner-geek of its owners Tesla may end up kicking an own-goal if they are not careful. It is doubtful that Musk will be able to retreat from championing the customisation of his vehicles by pulling the video gaming functionality without wearing 'Easter' egg on his face. Much like the social media frenzy that fuels Tesla, should the tables turn, the company could be dropped like a bad habit. The group think that drives it could well put the brakes on it as well.



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