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THE MIKE ALKIN SHOW

TALKING STOCKS OVER A BEER

Announcer: Free and clear of the chatter from Wall Street, you're listening to Talking Stocks Over Beer, hosted by hedge fund veteran and newsletter writer, Mike Alkin, who helps ordinary investors level the playing field against the pros by bringing you market insights and interviews with corporate executives and institutional investors. Mike sifts through all the noise of mainstream financial media and Wall Street to help you focus on what really matters in the markets. Now, here is your host, Mike Alkin.

Mike Alkin: Thanks for joining. It is Tuesday, March 19th, 2019. Hope you had a good weekend. Today, we're a day later than we normally schedule, but I just had some stuff going on yesterday, so I thought we'd get here today. Which is probably good, too, because I was in self-imposed traction yesterday for the most part. Feeling a little under the weather the last week or so, but I ... My Friday night hockey game ... We were a little short-handed, and not ... A lot of guys couldn't show up, so which means a lot of extra ice time for us and we were so short-handed we had one guy on the bench.

Mike Alkin: For those of you who don't play hockey, fast forward. For those of you who do, maybe you'll give me a little empathy here. It was really short-handed. There was a lot of stuff going on, guys couldn't make it. Normally a shift is a ... You go out for a shift and it's 45 seconds to a minute, minute and a half, and then your legs are done. If you play hockey you'll know. It's just like you're toast 'cause you're going out there pretty much full steam ahead and then your legs just give you and then you gotta come off. Well, these shifts that we were taking were eight and 10 minutes, and so skating involves a lot ... It involves everything. It involves your hips, your legs, your core, and your wind, but I could barely put my foot on the accelerator when I got in my car on the way home.

Mike Alkin: Normally Saturday, I'm a drop sore. Maybe a little, but not too much. My legs are in pretty good shape, and I've got my wind. But that 8x or 9x shift length really put me in a world of hurt for a couple of days. So ... A good hurt. I got to stretch and all of that. My wife was like, "Okay, enough. Enough of the 'Ugh, I can't move.'" But not that much empathy there. Same thing with the kids. They're like, "Suck it up, dad," but that is what it is.

Mike Alkin: But I was so consumed this weekend by a lot of family stuff and kid stuff and all that stuff all good. But that last week, that college cheating scandal. That was front page news everywhere. Really just kind of ... I couldn't ... Maybe I'm naïve to think that people do that, and it's surprising. I'm wired as a short seller. I am skeptical, but to see the lengths that people go through. Who was it, Lori Loughlin from I forget the show, Full House and her husband, a fashion designer, paid a half a million dollars to get their two kids into USC to bribe their way in through some fake charity, and Huffman was another actress I think it was, I think that was her name, that did that. Paid to have the kids take the test.

Mike Alkin: So what was going on was, if you're not familiar with it, there was an organization that pretended to be college consultants, and you know, that's a lot of people hire consultants for their kids to go to college. Where should we go? Can you get them tutors for the ACT or the SAT? I get that, you know. You want your kid to do well, and if you can advise, that's fine, but this took it to a crazy level. This was taking ...

Mike Alkin: It may have started out that way, from what I've been reading it may have started out that way, but then for those well-heeled parents, the founder of this company, I believe his last name was Singer, would say to them, "Listen, we could get your kids into school through the side door," and they're like, "What's the side door?"

Mike Alkin: "Well, the side door is we can go to college coaches and get your child in as a recruited athlete. Even if the kid didn't play. And the best I could tell, from reading it, none of them played any of the sports they got recruited for. So the owner of this consulting firm would go to college coaches and bribe them. Say, "Listen, I've seen numbers. They were $50,000, $100,000, $200,000, $400,000. Can you put this kid on the recruitment list?" Because recruited athletes will have a much better chance of getting into the school. And for a price, an assistant coach or a head could would say sure.

Mike Alkin: Then they would, for when it went to the admissions committee, in many cases they would photoshop a kid's picture on top of some athlete playing football or playing rowing or water polo or tennis. I mean, in one instance there was a kid going to USC, I think he was like 5'6'' 140lbs, and he was a recruited football athlete to USC, and oh, they decided he'd be a kicker. How do you ... First of all, that's just crazy to think that you're going to do that.

Mike Alkin: And in one case, a family paid $1.2 million to get their kid into a

school. And the schools were ... I mean, [inaudible 00:06:01] was one of them. Georgetown was another. USC. I mean, some real high ... University of Texas I think it was. Yeah, one of the coaches there. I mean, some high profile schools. And as I'm reading I'm thinking, "Who does this?" And I understand the competitive nature of it, but I mean my god. What are you teaching your kids?

Mike Alkin: In other instances, they were having people ... he would pay off the proctors at the SAT and ACT exam sites, and the proctors would correct the tests before they turned them in. So a student would go, fly to a different city where this proctor was, take an exam, and then the proctor would correct the answers. And then the kid would get an elevated score. I mean, what parent in your right mind ... What are you doing? A, it's illegal. B, what are you teaching your children? I mean, are you kidding me? That you want to teach them to get ahead not based on their own merits? I mean, what kind of a work ethic, what kind of principles, what are you doing? How crazy has it become?

Mike Alkin: Now look, I know the competition to get into college is ... my kids are a little bit younger than that point, but we have neighbors and friends, and they're all going through it, and it's a crazy process, but holy cow. Think about the learnings from your kid has ... I don't know, five schools they want to get into, and they didn't get into four of them, and they're really disappointed. What a great learning lesson. That's life. Maybe you could have done a little bit more along the way. Maybe something just didn't fall your way. Get used to it. Life doesn't always work out the way you want. Let's figure out how to deal with the disappointment, let's move forward, and oh by the way? If you didn't get into that school, hopefully I've given you all of the foundation or I, my wife, we've given you, and other parents have given them the foundation to be able to deal with disappointment. To be able to still prosper. To be able to still go ahead and be successful whether or not you got into that one institution that meant such a big deal.

Mike Alkin: Yes, I know the value of an education is important. I get it. Right, but it doesn't mean you have to break the rules and bend the rules and cheat and lie. That's just not okay. I don't understand what it has devolved into, and I don't know what the answer is. But the whole educational system, the competitive nature of it, the craziness. How many kids go to school that shouldn't even be in college?

Mike Alkin: I mean, one of the things I think about, and when I did the for-profit education space as a short two times over the last, what,

twenty years? It always struck me ... one of the things I noticed is that kids kept racking up more and more student debt because Title IV, what gives them the ability to get them money and grants and loans, just kept increasing and increasing and increasing, and everyone's gotta go to college. If you don't go to college, you're a failure, and you don't get ahead.

Mike Alkin: Well think of how many kids don't have the interest, the aptitude, or are better suited to do something else. And rather than going out and strapping parents with massive amounts of debt, or strapping themselves to go get a degree that may or may not mean anything to them, maybe they're really gifted at a vocation, and maybe their time would've been better spent going into a vocation and starting a business.

Mike Alkin: I was talking to somebody a couple of days ago, one of my neighbors, and he said, "You know, I could see with my four kids. I think two of them will wind up in vocational school, two of 'em wind up in college," and he said, "Two of them really have a great aptitude for plumbing," and he said, right? So he said, "I think about it, you go, you become a plumber, and you could go out and learn business skills at the school and learn how to plumb and get an internship," and he said, "Think about going starting your own plumbing company." Now, I live in a town where it's a pretty nice town. There's a lot of business owners. And I think of some of the guys who own the electric companies, construction companies that print, the plumbing companies. Really smart entrepreneurial guys.

Mike Alkin: And one of the things they say to me a lot is, "You know, sometimes we don't have the greatest competition because some of the guys don't have the skillset, and they didn't do it, and they landed in this. They didn't aspire to this," and these guys really went about their way, and they did it. Really talented guys. Super guys.

Mike Alkin: And so I think about what goes on in these homes where we've gotta get into these top schools. If you don't get into the top schools, it's a disappointment, and it makes the hair on the back of my neck stand up. Because look throughout corporate America, look throughout life. Look throughout the world. Look how many successful people there are that didn't go to Yale or didn't go to Harvard. Didn't go to Penn. For some people, it's great. Would it mean anything? Yeah. Okay, you didn't get into SC. You didn't get into this school or that school. Life doesn't end. You just deal with it, you move on, and you make your way.

Mike Alkin: And to see what people, what it has devolved into to the cheating and the lying and the bullshit that takes place for this, it's ugly. It's stinky. It's smelly. It's nasty. It's terrible. And I don't know why, it really consumed me. Not consumed me, but it really ... I just ... I read the news. I read a lot of stuff. Eh, okay next. Onto the next thing. But this thing has stayed with me. It really cuts the fabric, I think, of what's wrong with a lot of stuff.

Mike Alkin: So anyway, that's just a little rant on my part. Besides that, we are going to spend a little bit of time with a guest that I have recently met, but we have a mutual friend that we didn't know, and I followed for quite some time on Twitter, and I think he does really exceptional analysis. He uses his real name out there, and there's ... and really thoughtful. He's been a Wall Street analyst, money manager, on the sell side and buy side for over 20 years, and does great work on the short side, and one of the things I've really seen that I've really respected the work he's done on Tesla, and we are going to spend the show talking about Tesla and where it is, how he thinks about it. I'll chime in with my thoughts, and we're just going to kind of walk you thought the anatomy of a major controversial company, and you'll see how he comes out on it and his views, and I'll share my thoughts and views along the way.

Mike Alkin: So anyway, I want to bring on Ed McCabe. And on Twitter he is Ed McCabe, and we're gonna talk some Tesla.

Mike Alkin: Ed, welcome to the podcast.

Ed McCabe: Mike, thanks for having me.

Mike Alkin: You know, it's funny. You and I didn't know this, but we have a mutual friend, and I was talking at dinner ... I've been reading your tweets for quite some time, and I'm thinking, "God, he's really sharp," and I think we had one or two back and forth on a DM or something, but not a lot of interaction, and not too long ago I'm having drinks and dinner with this friend of mine, and he said, "You know, you should meet a really good friend of mine, Ed McCabe. He's on Twitter, and he ..." I said, "What?!" And so here we've interacted now and small world.

Ed McCabe: It is a small world.

Mike Alkin: I guess when you live in the tri state New York area, it's not that small a world, but-

Ed McCabe: And then the subset of Wall Street, and it gets real close real fast.

Mike Alkin: It gets real close real fast. Exactly. But I really enjoy you taking the time out, and I've watched your work now for it seems like a couple of years I think with your tweets that you opine on Tesla, and I really just fantastic work. Why don't you, before we start talking about our favorite company, why don't you give listeners a little bit of your background?

Ed McCabe: Yeah, I started on Wall Street in 1996, the sell side analyst at Oppenheimer and Co. It's gonna through several iterations now. It was bought by C of HD when I was there. And I covered enterprise software. Started as an associate, got my own coverage, and then moved on to the internet and moved onto Merrill Lynch during the dotcom bubble. So I'm well acquainted with what bubbles look like in their formation, and I'm well acquainted with the aftermath. So some of that background has relevancy to what's going on here with Tesla.

Ed McCabe: From there, I've worked on a buy side for a variety of hedge funds including my own, which I had in 2007-2013, and at the moment I'm recently a free agent. I worked for a small family office up until the end of February.

Mike Alkin: Great. So it's great. You've seen both sides. You've seen the sell side, you've been on the buy side, and I think that experience is invaluable because you see how the sausage is made on the sell side, and right, and you know how analysts form their opinions. You know the interaction between the companies and sell side analysts, and then on the buy side you see it. So what peaked your, and when, was your curiosity piqued by Tesla?

Ed McCabe: When I had my small little fund, the one we founded in 2007, we did energy industrials, and that bought us into alternative energy. So, largely on the alternative energy side we made money shorting, it was very bubbly back then, oil and skyrocketing. And these stocks in large part trading with oil and a lot of them were very bad businesses, at least in my estimation. Sort of solar. Solar city, later. Some power. I shouldn't say they were very bad businesses. Some of them were just highly overvalued. And you know.

Ed McCabe: But anyway, so we go to these conferences, and I did go to this conference where it was Tesla as a private company was presenting, I don't know, ten years ago or maybe a little more now, and I went to the meeting because it was just fascinating to think that we were gonna ... I was gonna see the first new car company in America in over 100 years, and that it was gonna be electric and obviously it wasn't investible for us because we only

did public companies, but just wanted to see what was going on. I knew Musk's history, and he was known from PayPal and other things.

Ed McCabe: So I went in and saw it, and that's the first time I got introduced to it.

Mike Alkin: Was he presenting at the time?

Ed McCabe: Yeah, he was.

Mike Alkin: What did you think?

Ed McCabe: Some of what I think now, and I'm not saying this critically. There's some people who present well. It's a skill, and I don't find him a particularly strong presenter. I'm probably maniacal about preparation, and he probably has to be beat by several IT points so he probably [inaudible 00:17:35] the preparation, and it comes across to me, but. If you're ... I don't think that's terribly important, but anyway it was a science project at the time. It's hard for you to refute anything.

Mike Alkin: Yeah, sure. No, absolutely. I mean so when I think of companies in the last 30-40 years that have had profound effects on how people's lives are changed whether it be medicine or technology or anything else, nothing that I can think of approaches the status that Tesla and Musk have achieved. And you know, I guess I don't know, right, see for years it's been this rebellious combativeness, and he's crafted this, "Me and Tesla against the world" David vs. Goliath scenario, and he really is a gifted orator. Albeit in his own stumbling, bumbly aw shucks manner that we were just saying. He's not prepared, but I think that almost kind of endears him to people.

Mike Alkin: You know, and it's netted him these tens of millions of fans around the world who think he's ... and hail him as a genius through his monumental efforts and brains and saving the planet, and it's got these loyal worshipers that think he can do no wrong. This mythical, cult-like image that he's created, and my background for many years is a short seller, and I run a nuclear power uranium mining hedge fund right now so electric vehicles are interesting to me, and for me I'd like to see EVs take over the world because solar and wind aren't going to power those vehicles. That's not happening any time soon because of the intermittency and the storage costs.

Mike Alkin: So if this surge in EVs that is being predicted is great, you need baseload power that delivers electricity when you need it, on time, all the time. And so nuclear right in that mix. So I root on AVs. But when I think about Tesla, I think about Tesla the company and then Tesla the stock, and then of course Musk is inextricably linked to them. You know, when I think of the company, I think of a company that's had a fifteen year head start in this space, and they developed a nice niche. Early on the Roadster, the Model S, the Model X. High end, quality cars, and ego and ambition got the best of Musk. Or it was always part of his fabric.

Mike Alkin: And the decision to become a car for the masses, I think, will cost the company to have fallen victim to financial burden that it just can't get out of, and I think his [inaudible 00:20:14] when people talk about genius, I don't know genius or not. I think his real genius is his ability to raise money and separate money from investors. And I think that's ultimately because of that skillset gonna lead to the downfall. Because I think he just bit off more than he can chew.

Mike Alkin: What I'd like to do is talk about, put our conversation into buckets today. And I'd like to talk about ... So we kind of touch on all the different aspects of it. I'd like to talk about the demand side, the supply production, the financials. We're gonna talk about the legal quagmire that Musk and Tesla find themselves in now. We'll touch on Eli's personal financial situation to the best you could cobble it together. The management and whatnot.

Mike Alkin: But let's start out with how the narrative has evolved and the importance that Musk has put on production and the focus and the reason for production which enables him to raise capital. Because if we could produce these cars, all we need is money. Talk about how you view both their production capabilities and the importance of production when it comes to the capital structure.

Ed McCabe: Well I mean, there's a lot of issues that could take this company out. Silver bullets, you know DOJ, SEC, any host of things. But the overlying these I think that is most important is not production, it's command. And almost from the get go, the sell side, the cult of [inaudible 00:21:57] on the concept that there was unlimited demand for the car. The concept of it is unlimited demand for anything other than somebody giving away money is [crosstalk 00:22:07]-

Mike Alkin: Sign me up.

Ed McCabe: The idea that an electric car, which is a tiny fraction of all of the cars produced and sold, would have unlimited demand was ridiculous to begin with, but it was swallowed hook, line, and sinker by the believers. And once you had that locked away, there's a narrative. Then you can just sell the story on, "Our only constraint is production," and you know what? [inaudible 00:22:37] where the issue is production is always a good story. It just means they can't handle demand. Well, you can figure that out.

Mike Alkin: Yep.

Ed McCabe: Although Musk is not, and Tesla really has not. But anyway, that was the narrative for a very long time. And while they tried to get production up to snuff, they built basically a two and a half year backlog of people who put down $1,000. This is in the case of the Model 3, and what we found very quickly is the timeframe was a couple of quarters in 2018, but essentially takes a role in that backlog, and so now we are sitting here, and we see demand collapse in the United States versus December which is their best month ever. January it was down like 74% versus December. February again down like 76-77%.

Ed McCabe: So we've seen two and a half years of backlog filled in a couple of quarters, and now we feel the demand clip is also concurrent with the having of the $7,500 federal tax credit that buyers get, and that have 1231. And what we've seen in terms of demand ... Now we've seen it in the US, but we saw it in Hong Kong earlier. At state level, we saw it in Georgia when some of the tax incentives on a state level were cut. We're seeing it in parts of Europe right now is that we've cut these tax incentives even marginally, demand goes off the cliff.

Ed McCabe: And you probably know this Mike from covering alternative energy and everything else, and there's a period of time where Germany was the biggest solar market in the world, and it has the irradiance of like Providence. Why did that happen? Because the incentives were so good back then that people installed as much as they could, and then they cut those incentives, and that market collapsed. I don't think this is much different.

Mike Alkin: You know, it's interesting too. That Model 3 wait list, what two and a half years ago or so, that car was promised at a $35,000 mass market less the $7,500 federal tax credit, and here you're looking at a $27,500 vehicle. And that was the claim. And as we saw over the last couple of years, they were selling $50,000-

60,000 Model 3s, and what's your take on the ability ... I know now they've come out with the $35,000, but we've seen so many people waiting and waiting, and all of a sudden as we started to get into third and fourth quarter where it was, Musk talked about what delivery hell because there was so much going on in the third quarter where the company, in an interview, he said that they were actually weeks away from closing the doors, essentially, to putting up the best quarter they ever had financially.

Mike Alkin: But they were ... talk about how you think the third and fourth quarter, which showed profits for the company, evolved. And why all of a sudden ... because a lot of people say to me, "Well what do you mean that demand fell off a cliff? I don't understand it. They just had all of these massive deliveries in the third and fourth quarter. Isn't that working into the waiting list?" Talk to listeners about why you think that's not the case.

Ed McCabe: Yeah, I mean the third quarter's interesting in a lot of ways, and you touched on a couple of things. I mean, in that same quarter where he, in retrospect I think it was the Kara Swisher at Recode said that they were weeks away from death.

Mike Alkin: Yep.

Ed McCabe: Also in that same quarter, we had the funding secured tweet, and also in that same quarter we ended up having the most profitable quarter the company will probably ever have. So in the space of 90 days, we almost went out of business, we committed the biggest security fraud in my career, and then we put up the most profitable quarter. We went from being the least efficient car manufacturer in the world to the most efficient or around there.

Ed McCabe: So, how did that happen? Well, it happened for a few reasons. One is he cherry picked the highest price people on the waiting list in those quarters. I'm not saying that's right or wrong, but that's a fact that if you put down $1,000 in March of 2016 because you were told a story about a $35,000 car, and a $7,500 tax credit, and then you sit there and wait and somebody is willing to pay $55,000 and can get it in three weeks, I don't know. There's something wrong about that that was misleading to being with, and Musk was still able to make use of the customer deposit money to fund operations and [inaudible 00:27:27] and the like. So there's something inherently wrong about that to me, but he was able to cherry pick the high priced variants in the car.

Ed McCabe: The other thing he was able to do, as you know from a July Wall Street Journal article, he was soliciting his suppliers to cut him rebates. So he was able to keep expenses lower. The other thing, and this is a big thing, is that they stockpiled a ton of tax credit. Zero emission vehicle credits.

Mike Alkin: Yep. Explain for listeners who may not be familiar with that what that is and how that helps them.

Ed McCabe: Yeah, basically in the ZEV credits and the GHG credits are roughly the same. A ZEV is a state program and GHG is federal one, but basically if you're GM, and you have predominantly an internal combustion engine fleet of cars, there are mandates that you have to have a certain amount of [inaudible 00:28:26] to your fleet. And if you don't, you can buy credits from someone who has them. Well, every time Tesla produces a car, they get credit for it because it's a zero emission vehicle.

Ed McCabe: So basically, some of those credits they can stockpile and use when they'd like, and that's what they did in that third quarter where, I forget the number, but the vast majority of their profit was related to the sale of those credits, and they disclosed the ZEV credits in a quarterly investment letter, but what they didn't disclose until the [inaudible 00:29:04] or the GHQ credits, which were much larger than the ZEV credits.

Ed McCabe: So the underlying profitability of the car business, despite the fact that it's the highest price variant, besides the fact that they got breaks from suppliers really even on that immaculate quarter, the underlying all of it is it is not a highly profitable business. Which we know is true in general, but particularly not for Tesla.

Mike Alkin: You know, the thing that stands out to me about the demand side is if the ... I think the company at early on in the Model 3 when they were taking deposits said there were half a million people. Then they kept that number quiet for a long time. Then they eventually came out recently and said it was 400,000 people. But as you got into the fourth quarter, what I found interesting, and like you I go around and there's a parking lot here in Syosset, Long Island, that I go and see 150 Model 3s sitting there, and I was there in December and January and February, and they were there. It's an office parking lot.

Mike Alkin: All of the people around the country you see many people posting videos and photos of hundreds and sometimes several hundred Model 3s sitting there all different colors and just sitting there not

moving. What I found ... What you see interesting in the fourth quarter is as they're trying to get the year end in, if you place your order today you could get it delivered in five days or a week or two weeks or whatever it might be. Now think about that. This is a company that supposedly makes, supposedly, makes 5,000 Model 3s per week. And if you had a waiting list of 400,000 people, how could you order a car today and get it in a short period of time? What about all the other people on the waiting list?

Mike Alkin: Which tells you those people aren't there to buy the 45, 50, $55,000 Model 3. They're there for the 35 that doesn't exist. What part of that basic common sense gets lost on people do you think?

Ed McCabe: Yeah, I mean if you looked at United States light vehicle market.

Mike Alkin: Yep.

Ed McCabe: [inaudible 00:31:27] seventeen million units. Obviously it's typical when ... seventeen and a half, probably eighteen peak. At the $45,000+ price point, you only capture about two million units or 12% of the market. Once you get to 35,000 you get another 20% of the market. So you get 2% of the market. But once you get to $35,000 with that $7,500 tax credit, to quote roughly a $25,000 car, that's where you address 60% of the market.

Ed McCabe: So for a very long time-

Mike Alkin: That's the mass market, right? The big mass market.

Ed McCabe: That's the mass market. And by the way, just so people have a little background who don't know, the auto manufacturing business in general is horrifically hard.

Mike Alkin: Yeah.

Ed McCabe: And mass market manufacturing you can do it while over the course of an economic cycle, you'd be lucky to earn your cost of capital to be ... you'd be lucky to get a eight, nine times multiple, and right now GM and Ford are trading at five and a half times. Then you're lucky to avoid bankruptcy. So that's the background of the industry we're talking about.

Mike Alkin: Yep.

Ed McCabe: It's brutally tough by the guys who do it really really well.

Mike Alkin: And for a long time.

Ed McCabe: Yeah. Yeah. So this is hard, precision manufacturing. It's not ... You can't take the Silicon Valley software era internet approach to it. You know, move fast and break things, to get that market share.

Mike Alkin: Talk about that for a second. So because if you think about a normal car cycle, a product life cycle, it could be four five years from concept to testing to design to testing and bringing it out there. That's not the case with Tesla.

Ed McCabe: No, but they're dealing with the repercussions of that. You know, in terms of prototyping those manufacturing lines and those types of things, what are [inaudible 00:33:15] gonna do? They were gonna make the machine that built the machine. I mean, they were gonna be the most highly automated manufacturing plant in the world, and gonna break the rules, not break the rules, or break the mold or the great manufacturer of like Toyota was kind of the gold standard. And what do we find out? We had to whip a lot of the automated stuff out and put humans in there. But that would've been something you would've figured out prior to production. And then when the cars and manufacturers, you know the first [inaudible 00:33:43], they weren't extensively tested. They went to employees who effectively data tested them for a while. And I'd argue that the customers who see them today are still beta testing them.

Ed McCabe: And what do we see? Well, we see quality issues in terms of production. Paneled apps, paint issues, suspension issues. And then what do we also see? Well, we just spent through our winter where there was a significant number of Model 3s on the road in places other than Sunny California, and we find, and you'll find it with your cell phone too with the lithium-ion battery, that the battery range degrades significantly in [inaudible 00:34:18] temperatures.

Ed McCabe: So all things that GM, Ford, and every other major manufacturer find out because they kept their line, they test their cars, and then the cars they test they destroy as opposed to sell. So, I think because it's a Silicon Valley company in many ways, or if it sees itself as such, it's located there. That concept of moving fast and breaking things frankly has been the business model that has worked. You know, you could argue [inaudible 00:34:53] in the database software business was not the best database but because they got out there and took market share, and they got it right on version 3 and version 4 and version 5. That's okay because you don't [crosstalk 00:35:05]-

Mike Alkin: That's such a good point.

Ed McCabe: ... database goes down, but when your car is not tested properly, there are much bigger repercussions.

Mike Alkin: So here we sit at sub-35,000, the less the tax credit, where half the market sits, and now they come out and say there's a $35,000 version that people can get yet it doesn't seem to have, at least by all appearances, it doesn't seem to have stimulated demand. What's your view? Because here it is, a growth company, right, that reduces CapEx significantly, doesn't spend near the amount of level that they should spend on capital expenditures, the day they announce the $35,000 vehicle, they announce a significant work force reduction. They announce closures of the stores which they change their mind on a week later or two weeks later.

Mike Alkin: What's your view on the actual demand for the vehicle ... because now the tax credit's been cut in half, and then six months later it gets cut in half again, and it will keep getting cut in half. What do you think the actual demand is for the Model 3 in the US?

Ed McCabe: I, you know, I'd be ... Musk thinks it's 350 to 500,000. I think it's below 350 to me which with Musk of course it's gonna be below his range, but I just think ... and part of it, to be honest, here's the other issue. The brand is the strongest thing that Tesla has. Tesla's not good at manufacturing, but now we've learned they're not good at service. They're not good at having parts out there. They ... So the one thing that Tesla had is kind of sell a brand, this aspirational brand, they've done all the things you can do to kill it which is again the quality, the service, the lack of, or the under-invested in, charger network which is important.

Ed McCabe: And then they've done what you do to kill a premium brand. If you think about Rolex, it's an aspirational [inaudible 00:37:37] brand, and the way Rolex could destroy its brand, and they retain their value. The way Rolex could destroy its brand is to offer a watch equivalent to Kanye, and they can buy these Rolex that's like a Timex, the high end Rolex doesn't hold the same prestige.

Ed McCabe: And I think, to your point, going to the mass market, there's many reasons it wasn't a good idea. That was one of the major reasons. Because I think Tesla could have aspired to be a high end niche auto manufacturer, and that's what they should've stayed. And to move to the mass market-

Mike Alkin: Yeah, I agree.

Ed McCabe: A, they've gotten to that very very difficult mass market environment I described where the competition is fierce and the multiples are low and the risk of bankruptcy is high, and earning your cost of capital is typical, but you know what? Ferrari? Porsche? They have a nice bid, and that's where he should have stayed and competed. And again, in addition to it being a difficult transition to the mass market, I also think the value is high end business, and you can see that in the price cuts we're seeing across the S and the X.

Ed McCabe: I think that we will see the mass market was deadly in many ways.

Mike Alkin: And what's your view on the pomp and circumstance surrounding the Model 3s getting shipped to Europe and the Shanghai factory coming online which I find unbelievable by the way that they're going to be producing vehicles in Shanghai by the end of the year according to them, yet the best we could tell, it's still a swampy land. They just got the financing for it which has to be paid back almost immediately, and who was it? VW that built the fastest car plant ever and spent $2 billion or something like that?

Ed McCabe: Yeah, and I think it took two years.

Mike Alkin: In two years, exactly, but these guys are gonna do it and here we are in March and we've hardly had any progress whatsoever. What's your view, though, on Model 3 as it hits Europe and what's going on in China? Obviously everyone points to it being the biggest EV market, but how do you view the evolution of that?

Ed McCabe: Yeah, I mean I think Europe's already showing us it's underwhelming. I mean, I think the auto book there is estimated to have been around 20,000. So let's say that Tesla did produce 5,000 a week for four weeks demand, and I meant equivalent of what is four weeks of production, five weeks of production.

Mike Alkin: Yep.

Ed McCabe: Once that we get through this quarter, we're gonna be back to a place where the backlog of Europe has been largely failed, and we're gonna deal with just what is the organic demand and there are ... and here comes the competition. So, I think ...I think Europe is disappointed. In terms of Shanghai, not only is that loan like $522 million US dollars across four banks, so a nominal commitment from the banks, but it's not nearly enough to build the plant, and like you said, the plant right now looks like a flood plain. We do see footage of it from time to time, and forget about

can you get the structure built by the end of the year, but we need lead times for the machinery that needs to go into those factories.

Ed McCabe: So it's inconceivable to me that they could have any meaningful production by the end of this year, and to your point on China, yes, it's the largest EV market. It's also wildly competitive. And gonna be less profitable doing anything Tesla does. I think whether them get it done, whether the company can stay, a growing concern by the time they get it done, I don't know. But the call option for China, to me, is that they just had their national banks lend to Tesla. And if it doesn't work for Tesla, they'll have a 3/4 built plant that [inaudible 00:41:24] will take over or one of their domestic companies.

Ed McCabe: I see it as kind of a low risk maneuver for China, and unlikely success for Tesla.

Mike Alkin: One of the things that'd always fascinated me about the Tesla story is how Elon has focused everyone on production, and it was the 5,000 a week, and it goes back, and it just woefully missed, and the thing that ... You know, you've been around in this business a long time, as have I. Good news gets the stock price rewarded and up until very recently, bad news the stock price even goes up. And when you think about a company over the years where it's had so much capital raised, so much leverage, has production target, and I'm not even talking within a country mile they don't get met yet people don't care. How do you process that, and what do you think drives that?

Ed McCabe: Yeah, I think that is changing. I think that's primarily changed now.

Mike Alkin: Yeah, I agree.

Ed McCabe: Because this is now a broken growth story. So the people who owned it, I think did believe or want to believe that there was insatiable demand, and the only constraint was production. So they did believe that. Now, they will see in Q1 that that story is broken. And they will see Q2 is gonna be worse than Q1. And that's gonna be a hard time for the growth guys who go in front of their investment committee and tell this open ended story.

Ed McCabe: The other thing that was part of the call option on this, and a large part of some of the sales side analysts' price targets was this Tesla mobility or the time the vehicle and the ability to use your car to generate revenue for yourself, and what we found is because of the underinvestment in R&C and CapEx that Tesla is nowhere found

stride in it that despite what Musk may say. I say nowhere, but Navigant just put out their ranking of eighteen participants here, and they got Tesla I think seventeenth or eighteenth. So I think the idea of unlimited demand, I think the idea of autonomous potential of autonomous vehicle and then I think the other part is that, and I don't mean to say this to sound dismissive or [inaudible 00:43:46], but this is a cult, and a lot of the cult is financially illiterate. They certainly don't understand valuation.

Ed McCabe: And if you think they look at a balance sheet or a cashflow statement, you're wrong, and I think that's a lot of it too. That the people who own this, they own it because of the cult of Elon Musk. They own it because they believe it's how you signal your love for the environment. Who doesn't love the environment? And by the way, I'm all for electric vehicles. But this has become the way that people show their support for A, the cult figure, B, the brand which they aspire to, at least somehow, and their love for the environment.

Mike Alkin: Well the thing that's shocking that has really surprised me, and I struggle because I look at it from a financial perspective, and I just don't see how they get out of this quagmire that they're in. And I feel badly at times for those who are mom and pop or retail investors and believe in Elon, right? And I read ... You're on Twitter a lot, I'm on Twitter, and I read the defense of him and the defense of the company, and a little bit of it is off the reservation for me in terms of their love for him, but they truly don't, I think, many of them, don't understand what to look for, and they think that hope and saving the world trumps financials obligations, and it just doesn't. That's gonna be a tough lesson for people to learn.

Mike Alkin: The ones that I can't get my head around are the big large shareholders that ... It's almost as though they're financially innumerate because I can't even ... Look, I understand early on in the growth story that the whole thing you're talking about autonomous and the tech and people coined it a tech company, but at some point in time when you ... How do you have a growth company whose capital expenditures are precipitously declining while they're in the early stages of a mass production launch? That just doesn't square.

Mike Alkin: Right? That just doesn't make sense to me.

Ed McCabe: Well I mean, two things. One is you've seen some of the big institutions start to lighten up significantly. T. Rowe cut their position in half. [inaudible 00:46:12] may have cut it by 70%. It's important for people to know, this is a very tightly held stock. We

must own 19%. Baillie Gifford is now the biggest shareholder that is probably close to 10%. When you had T. Rowe in there, they were 10%. [inaudible 00:46:32] was probably something close to that.

Ed McCabe: So I just took Musk and those three holders were probably speaking for close to 70% of the stock that for a very long time didn't trace. So really, you know, the market ... I haven't done this calculation in a while. It was turning over like every 14 days. So [inaudible 00:46:52] turn over every fourteen days, almost by definition aren't trading on fundamentals. So I think that was a lot of it as well. I think the things you said about lack of ... We've got CapEx to annualize that that $1.3 billion in the fourth quarter, and maintenance [crosstalk 00:47:12]-

Mike Alkin: I mean, come on. In '17, they were what? Over 3 billion at least.

Ed McCabe: Right, and that's when you were kind of-

Mike Alkin: It's hard to ... That's not even maintenance, CapEx at that level.

Ed McCabe: But him overseeing them, what do we see now? We're seeing price cuts across the boards and move metals to convert working capital into cash. We're seeing three known layoffs in the last ten months, and probably some under the radar screening ones.

Mike Alkin: How about 20% of the company probably if you do the math.

Ed McCabe: Exactly. And then you're seeing store closings, and now we're gonna reverse that decision to some degree, and that's only because like a lot of things at Tesla, was done by the seat of his pants, and the landlord said, "Hold on a second. You've got these termination fees," and so you have that. You put all those things together, that's what a company does when it's restructuring.

Mike Alkin: Yeah.

Ed McCabe: And by the way, in chapter 11, you can reject leases. And then you renegotiate with creditors and suppliers and everything else, and you [inaudible 00:48:21] of the company and you save as many of 41,000 jobs as you can to preserve the brand, do all those things in a chapter 11 which is where these companies should've been probably a year ago. For a variety of reasons, so I don't think that'll happen. But yeah, to your point of how you go in and talk to your PM or in front of your investment committee and continue to put to say, "Now we're just for Tesla," you can't.

Ed McCabe: And I think that's started a habit, and I think Q1 we'll see deliveries in early April. We'll get the ... later in April we'll get the Q1 conference calls, and then maybe early May we'll pick a 10Q. And there's a lot of catalysts coming forward for the company, and other than ranking capital, I couldn't think of a positive one at all.

Mike Alkin: And also this company has had such a massive head start for fifteen years with by the way technology, they didn't invent, which I laugh when people talk about the EV and they invented the EV. But the thing that I think it seems when I talk to bulls, they scoff at the competition that's coming. They have had no competition to speak of for all this time. Like I said, the S and the X, yeah cool cars. I've been in them. My friends have 'em. Yep, great. But now you're sitting here at this mass market, but at your higher end cars which are your higher margin cars, are now going to be besieged with competition coming from the likes of the folks of Audi and Jaguar and people who know how to make cars. And the spade of them are coming online.

Mike Alkin: What's your view ... So we're talking Model 3. What do you think happens to the higher margin cars that we've already been seeing decline in growth rates, but how do you think that plays out for the S and the X?

Ed McCabe: Yeah, I mean and by the way all this emerging competition will have the benefit of that $7,500 tax credit.

Mike Alkin: Exactly.

Ed McCabe: Just as Tesla loses it. You know, I've been in the S a couple of times. I've been in the 3 a couple of times. The S is a nice car. Whether I'd want to own it and deal with the maintenance and insurance and all the other expenses that go with already an expensive car, I wouldn't, but it was a nice ride. Bottom line, though, I think that car was designed in 2012. And it's 2019 now, and the Tesla sycophants want to tell me, "Well this car is like an evergreen car," because of software updates and the like. They can tell me that, but the bottom line is that it's mostly a hardware company, and cars start to look dated when they're seven years out when it comes to design, and I've heard nothing of a refresh, and I don't think there's any capital to refresh the line. On top of losing the tax credit, and on top of some of the quality and expense issues related to insurance and fixing the car, you're gonna be competing against very good manufacturers with essentially brand new cars with a tax credit.

Ed McCabe: So we're already seeing the S and the X decline, and I think that continues unless it gets refreshed in a significant way.

Mike Alkin: So if we recap so far, we have a growth company that has continuously-

Ed McCabe: It's a broken growth story.

Mike Alkin: Exactly, a broken growth company, but if we give the bulls their due, and then we'll reverse that in a second, but we have a growth company that's going to meet this insatiable demand around the world, and they're the first mover advantage. They are led by a visionary who's changing the world. That is spending a significant amount less for this growth company, has levered the balance sheet 'til kingdom come for this growth company, had two profitable quarters that pulled out every stop that they could possibly think of and guide it down for the current quarter, and they are sitting there facing a torrent of competition that's coming from really established car makers.

Mike Alkin: Now, if that wasn't enough of a challenge in and of itself, then we have to just take a look at all of the other stuff that's going on. So a broken growth company as you, I think rightly, called it, but now you've got stuff that I haven't seen before. I've probably seen it but not at such a high profile. I mean, obviously we could go back to the early 2000s with a lot of the shenanigans that took place, but the legal quagmire that Musk finds himself in ... yeah, I think people root ... right, the bulls root on Elon. The cult roots on Elon. Oh, go against the bad SEC.

Ed McCabe: Yep.

Mike Alkin: Right? So Elon gets himself first in trouble with the $420 go on private tweet which turned out to be completely not true, and he signs an agreement that he's going to pay $20 million, Tesla's going to pay $20 million, and any tweets that come from Elon will be approved by Tesla. Well, it turns out he was recently out there saying that they would produce, what, half a million cars, when the guidance was for less than that. So the SEC went in and said-

Ed McCabe: Yeah, I mean I could give you just a little chronology on the [crosstalk 00:53:45]-

Mike Alkin: Yeah, why don't you do that?

Ed McCabe: So January 30th, which was the earnings letter, which came out a little after 4:00 eastern time, they decided delivery guidance of 360,000-400,000 cars for 2019. That's for the Model S, the Model X, and the Model 3 all together. Around 5:30 the same day on the conference call, Musk says there may be demand for 350,000-500,000 Model 3s alone. So I've got 260-400 in a letter [inaudible 00:54:20], and an hour and fifteen minutes later he's talking about Model 3s, a subset of the total, at 350,000-500,000.

Ed McCabe: On the 19th of February, he puts out between that he's gonna do ... he puts that out around 7:15 at night. That'll be a famous tweet in history. But 500,000 for around 2019. And the lawyers rush over to him, meet him at Fremont, they amend and retract what he said and said he'll be at a 500,000 run rate by the end of the year, but they'll do 400,000 for the year. Then on the 25th of February between ... So the tweet that SEC forgot to read the transcripts so you're referring back to a 350,000-500,000 Model 3s. Embarrassing. So that's what he says about the SEC in terms of their interpretation of all of this coming led [inaudible 00:55:10].

Ed McCabe: And then on the 28th, when they announced the $35,000 Model 3 and the closing of stores and the layoff of people, he tried a conference call which was a brazing violation of [inaudible 00:55:23] by any way I can read it. He talked about 350,000-500,000 Model 3s and 70,000-100,000 Model S and X. Total that up and that's 420,000-600,000.

Ed McCabe: So I've got ... Since January 30th, I've seen ranges from 360 to 400 total and now 420 to 600 total, and to this day I don't have an AK that clarifies any of that. So I've never seen anything like that. And so the SEC obviously on that, they've come ... They obviously settled with him regarding the funding secured so that was a securities fraud case and they settled it.

Ed McCabe: And then all of his tweets are supposed to be preapproved. And it was obvious that that tweet on the 15th was not preapproved, and so they went and filed this show cause order for the court to show cause that Musk shouldn't be held in contempt, and we're now ... They filed the show cause order. He responded, made some novel and ridiculous argument that he could ... We learned that none of his tweets have been preapproved. I think the SEC was generous in that they only went after Musk, and they did not name Tesla because Tesla easily could be held in contempt for not implementing what they'd promise the court they would do.

Ed McCabe: And there may be a very tactical and strategical reason as to why they're kind of going after one and not the other, and that Musk argued that A, he would only get the tweet approved if he deemed it as classified materials, and that was in complete violation of the agreement he signed. And then he said that his first amendment rights were being violated. The SEC saw that response to their show cause order and say, "Hold on a second. Either you ... factual assertion."

Ed McCabe: So last night, they filed and what they did there was kind of interesting to me. They again reiterated with no preapproval of any tweets. Then they went on to cite ten examples of other tweets that had been made that hadn't been preapproved. And then there was a footnote in there where they said they also contacted Tesla. So they contacted Musk and Tesla 'cause they were concerned about Tesla' compliance with the final judgment. You know, the settlement they agreed to. So are you starting to invoke Tesla in this now?

Ed McCabe: Now the thing that was passionate from this filing from the SEC was that they did not ask for a director and officer ban. I'm not a lawyer, but I'm not gonna try to read between the lines too much here. But I would just keep in mind that it's not only the SEC that's scrutinizing this company. And it's not just relative to funding secured. It's also related to production values in the past, right?

Mike Alkin: Yep.

Ed McCabe: I mean, this company raised capital at one point $8 billion high yield offering in late November, and that was marketed based on the concept that they could get the 5,000 a week by the end of 2017, this is Model 3, and 10,000 a week by the end of 2018, but the Department of Justice was also investigating both those issues. Funding secured and the production guidance.

Ed McCabe: I'll tell you what. I know where they're gonna go with this, the Justice if they're gonna pursue it, and they've been in there a while. They're gonna say, "Well if you were gonna do 5,000 a week at end of '17, you better show me, and you better be able to prove, that you had production capacity. And if it's gonna be 5,000 a week, well you better have 20,000 tires on their way," and the same thing goes for 2018.

Ed McCabe: And there's a private lawsuit out there [inaudible 00:59:02] vs. Tesla, private litigation. There's like twelve full-time employees who are attesting to the fact that there was no chance they can hit

those production targets. So all I'm saying is production guidance was his issue. Already being investigated by both of those SEC and the Department of Justice, and now I just gave you all of the issues he had with production guidance just in the last month. This would be the most hot button issue for me if I was him. If it was an issue I was gonna be most careful about, it would be that, and he just brazenly disregarded the whole order.

Ed McCabe: So I don't know how Judge Nathan reacts. But basically, the SEC threw it in her lap last night and said, "We're not gonna recommend ..." because that's kind of what will often happen. The SEC will suggest the judge what they should do, or they'll request something. They didn't. And I don't know if that means, "Hey Judge Nathan, we can't control this guy. He's violating your order. He's in contempt of court. He's not in contempt of the SEC, and we're punting it to you." I don't know how this'll work out, but the one thing that's clear is that ... Last time he was gonna ... stock went down on a Friday, and he settled on a Saturday. So he's often very defiant to start with, but it really does seem like he's laid down the gauntlet now. That he's gonna fight this.

Ed McCabe: Now why might he fight it? I don't know.

Mike Alkin: But why ... if you think about ... one of the things that I just can't get my head around is here is he talking on the Recode podcast. He had mentioned, and saying that they were weeks away. It was really cashflow hell essentially. That's my term. But they were on death's door. To putting up those quarters that we just talked about earlier, but with ... He could have at any point in time gone out and raised five, six, seven billion dollars, and I think at one point in time investors would've looked right past that delusion that came from that, and he didn't do it.

Mike Alkin: And here we fast forward to today. I mean, look, the deliveries for January and February, they're falling off a cliff. I see here today they just tweeted while we're on the phone. Due to unusually volume, Tesla unable to process all orders by midnight on Monday. So, the slight price rise will go into effect Wednesday. I mean, it's just the stuff they do, right, that's their promotional stuff.

Ed McCabe: That's so funny that it can't process orders on its website.

Mike Alkin: Right. But that's what they do to ... Right, whatever.

Ed McCabe: Probably seen these 100 times now.

Mike Alkin: Yeah, exactly. But here's a company that is by all appearances and by any financial literate person's looking at it saying, "They need cash." And they're going to need cash. And he probably still could go at least raise a few billion dollars. Why take on the people who are gonna decide whether or not you can go do that, whether or not you can get approved to do that. The SEC. What is the point of him fighting like that, and why not just go make it easier on yourself and raise capital?

Ed McCabe: Yeah, I mean I'd say two things. One is that if I were advising him, this is not legal advice. This is just common sense advice. And I got caught not having my texts preapproved, what I wouldn't do is defy it, but I would be a conciliatory. I would say, "Hey, we made a mistake," and something wordsmith where you're filling some type of contrition. And he took the exact opposite approach.

Ed McCabe: Now after raising capital, he ... You can go back to the second or third quarter, and he kept saying he didn't want to raise capital, they'd be profitable going forward, and I still wonder if he took that position because he could. Because historically, his stocks reacted very well to raising capital. People would understood the need to raise capital to pursue China. He put up his quarters, especially that third quarter. His stock rocketed.

Ed McCabe: But I often ask myself, going back to the ... I think it's over seven something secured. Did he even know at that point that company couldn't raise capital, and they, again, they had that convertible note coming due in March with $920 million that was paid, but was that an effort to get the stock sustainably ... that week, that third quarter which was manufactured with every gimmick in the book. A profitable fourth quarter, was he hopeful that he could just keep the stock above 360 and pay off the convert that way and preserve cash?

Ed McCabe: But I guess what I'd ask, Mike, is you've been around for a while. Could he get a registration statement effective right now? While being held in contempt.

Mike Alkin: Not being a lawyer, but it'd sure seem very difficult.

Ed McCabe: I mean, I just don't ... To your point, I don't understand why you would put the company anywhere near existential risk if you could go issue equity and capital. [crosstalk 01:04:22]

Mike Alkin: They would have had until, maybe not today, but anytime until recently, especially in the third and fourth quarter when you put

up those big numbers, they've been able to raise capital in the blink of an eye in theory, right?

Ed McCabe: Yeah, but he's not gonna go on a [inaudible 01:04:39]. They haven't done a true equity offering in years.

Mike Alkin: Yep.

Ed McCabe: That high yield deal is 144.

Mike Alkin: Yep.

Ed McCabe: You can set a parameter for that and disclose ... Well, in a different set of investors, and now you're at a point ... You want to go on the road and market a deal, let's say you could get an effective registration statement? Well, it's only gonna become effective when you disclose probably either the SEC or your under writers, are gonna require that you disclose more deep or everyone's gonna ask you. More about the DOJ, more about the SEC, more about the true reservation list, more about the order book in Europe.

Mike Alkin: They don't want the klieg light shined on 'em, it seems.

Ed McCabe: I'm sorry.

Mike Alkin: They don't want klieg light, the big bright light, shined on 'em.

Ed McCabe: It sure seems like it. You know, this other science that's dumped in front of me. You talked about ... You touched on the executive turnover. And we know that in ... We lost a chief accounting officer and a treasurer in March of last year, and then August we replaced the chief accounting officer with Dave Morton who was like a 23 year CFO of Seagate. I have to think he thought he was gonna be heir apparent to the CFO because it's a weird move to go from CFO to chief accounting office and Deepak's obviously one of the leads.

Ed McCabe: He left in 27 days, so god knows what he saw. And then Dane Butswinkas who is one of the most reputable attorneys from Williams Connolly, comes in as general counsel. He leaves in months at that. Then you had Deepak resign. Oh by the way, Butswinkas is replaced by a 40 year old pretty much a Tesla lifer as general counsel. And then Deepak as CFO resigns, and he's replaced by a 34 year old CFO. There couldn't be a worse combination than an imperious and financially exposed CEO like Musk and 34 year old CFO and a 40 year old [crosstalk 01:06:51].

Ed McCabe: You're a $50 billion company. Go out there, hire a [inaudible 01:06:54], talk to every big guy or gal, and bring them in. You know, somebody's really really seasoned with a lot of pedigree doesn't seem they can do that anymore. Gotta keep it in the family.

Mike Alkin: That's my view as well. I share that.

Mike Alkin: So one of the things you think about when I look at the company is the amount of what appears to be personal leverage that Elon has to buy back stock. Right, I mean the last numbers we saw were over $600 some odd million that Morgan Stanley had lent him, and then there were other deals that came along. Solar City did a raise, and I think he participated there in some others, and we don't know what the stock price is, where those loans start to get called. Do you have a sense for where that is, where you start to, margin loans start to come into play?

Ed McCabe: Well back to the number. I mean, I think the fact that the last time we saw disclosure around how big his loans were, I think that was Jan in '17. Might've been in the perspectives related, the high yield deal. And I think it was 624.3 million. Since that time, we know he's bought stock on the open market multiple times. He bought stock in a private transaction. He put $100 million into the Boeing company. He put $101 million into SpaceX. SpaceX has since done a senior secured deal and an equity deal. All of the SpaceX deals were under subscribed by the way. I have a hard time believing he didn't participate in all of those. He stayed a pawn to the SEC. He has probably a monthly budget that rivals Floyd Merriweather Jr. So it's easy to see that he'd need a billion plus in ... and he mortgaged all his property recently in December.

Mike Alkin: Recently in December, right? At five properties or so?

Ed McCabe: Yeah. So you know, his equity, it sounds strained to me. So anyway, you add it all up and probably got a billion dollars of margin debt. As to when the margin call that's triggered, it's very hard to say. People speculate. You know, it's in the high 100s, low 200s. But the bottom line is would he petition the board and would the board ... 'cause they let him do anything he wants. Anyway, allow him to pledge more shares. I think that's probably what would happen now.

Ed McCabe: I would hope they would disclose that in a filing. Although I don't always trust that they disclose everything they should, and I think that would alarm the market to some degree.

Mike Alkin: Well let's go back to what you said earlier, though. You used the term public restructuring, and the cutting price is increasing the ABL line. All the stuff that you would see, like he's just trying to generate cash, and so as the guy who makes the ... as the CEO of the company, and having so much at personal risk, if he were to file, I mean think about ... he could get wiped out.

Mike Alkin: And so think about the impact that has on his decision making. And you could say, "Oh, well the board is there to protect them." Are they? I don't know. I mean, what have they done so far?

Ed McCabe: I mean, the board's [crosstalk 01:10:07]. Yeah, the bottom line is that you hit the nail on the head. It's the board that let this company get in this situation, but even Elon's competing interest of his own personal equity, and his exorbitant lifestyle and maintaining it, and making the absolute best decision for the enterprise, its stakeholders, its employees, is that corrupted ... And I don't mean corrupt in like necessarily ... even if it's subconsciously. Now, it is the board that should step in, and it may be getting close to that time. It's just a question ... You know, the board is so insider at this point. Kimball is his brother, and Antonio Gracias is one of his best friends, and Gracias is an investor in space. Actually, is an original investor in Tesla, and Musk has money with Gracias' venture capital fund.

Ed McCabe: [inaudible 01:11:08] little buddy who used to race McLarens with. You know, there are some people who might genuinely be independent like Murdoch and Linda Johnson Rice and Kathleen Wilson Thompson but the bottom line is that this board has been fabulous. It's done nothing.

Ed McCabe: So now we're at a point where they gotta start thinking about their own liability, and we're well beyond that point. But now things are getting, it seems, pretty dire, and in giving them a convenient excuse to go after him related to the SEC ... The problem is, and this is a problem the SEC has, is a problem that Clayton had, is that he doesn't want to crush investors, and there's no way to separate Musk from the company without crushing investors, but there is also no way the SEC can be credible and let this go on. So it is a really tough dilemma for them.

Mike Alkin: Well you know it almost seems like the SEC is giving every signal they can to investors you should go. But in an orderly fashion. Without just yanking the carpet right out from underneath them, it seems.

Ed McCabe: The stock's even up a little bit today. Any other company I've covered in my history that had any number of things, this kind of restructuring without the protection of bankruptcy, the loss of the general council overnight. The loss of all these financial executives. There's so many things where I woke up, and I said, "If this was a normal company, it'd be down 20%," and yesterday it was more damning stuff from the SEC towards Musk and his stock's up.

Ed McCabe: It's funny, you can track on like Fidelity and track on another website that tracks Robin Hood which are all good proxies for individual investors. The account holders on Robin Hood are at all-time high for Tesla.

Mike Alkin: That's amazing.

Ed McCabe: Yeah, if you think about all the bad news we've received since the layoffs of January, I think it was 18th. To date, every piece of news has been negative. Whether it be demand, whether it be laying off people, whether it be shuddering its doors, whether it be the SEC, whether it be the exit of the general council, whether it be the underwhelming hire of a 34 year old CFO. The guy's academic credentials are pristine, but he's just not experienced enough for a job like this.

Ed McCabe: All of these things have happened, and the best proxies I have for retail investors have gone through the roof. They buy every disc in his stock, and I'll tell you. I get some of it. We're in an era, we're in a tenured era, of passive investing and ATF where people really don't know what they own. They own the spiders or they own the queues or they own the [inaudible 01:14:04] ETF. But here's the difference. Most of those companies are growth companies. Most of them, by and large ...

Ed McCabe: We can argue whether Amazon is overvalued or not. I don't think we can argue that Amazon is an excellently managed company, and the bottom line is like ... Amazon doesn't have any existential risks. You may Amazon and it may be down 30%, but you'll live to fight another day. What the retail investors don't know because their financially literate is that there's no risk of a [inaudible 01:14:33] of equity capital here, and that's what's kind of dangerous about this particular company because they [inaudible 01:14:40] with all the other high tech growth companies in the Valley, and it's differently structured financially, and it's much differently managed, but they don't know that.

Mike Alkin: Do you ... I mentioned earlier in the podcast Musk's ego and his ambition. Do you think when we think back to other high profile companies that have just really had difficult times, you go back into the early 2000s and stuff and mid-2000s. You didn't have the onslaught of social media. I mean, you had young message boards and stuff, but people talk about Musk's IQ, and gee I don't know what it is. I think I said earlier that I think he's a genius marketer and capital raiser. I don't know about the other stuff. I'm just not qualified to state.

Mike Alkin: But do you think he ever anticipated amongst his 25 million followers that there was something out there called TSLAQ, and the Q is for when companies don't trade anymore? In our [inaudible 01:15:43]. You know, because I laugh at the FUD. Right, all the people come out and say that the Tesla sure has spread FUD. And some journalists are out there who talk about people in mom's basement as the short side. As a guy's been doing this for almost 25 years, and is a professional short seller for my whole career, I can tell you it is not knowing all the names. You have your name out there so it's different, but it is some of the singularly hands down best work I've ever seen bar none, and it's independent people just whatever they do and putting work up there.

Mike Alkin: Do you think he ever anticipated, "Oh my god. Every day there's someone coming at me. There's hundreds of people coming at me with stuff." It's hard to stay ahead of really smart people. You may be a genius, but when you've got the collective brains of a lot of people who know what they're looking for, it's not that easy.

Ed McCabe: Yeah, I think I'd say a couple things. One is Musk, I'm sure there's some genius in him, but there's always efficiencies in him, and I think one of them is long term thinking. You know, and we can see in Tesla it's running week for week now. Maybe it has to be, but I've never seen something that's been a really long-term strategic plan at Tesla.

Ed McCabe: So where Musk differs than any CEO I've ever covered is that he's a celebrity, truly, and whether it was because he consulted to Robert Downey Jr. when he played Tony Stark in Iron Man, or whether it's because he has 25 million Twitter followers or whether it's because he is this renegade defiant cool guy in the eyes of so many people, that's where he cultivated this.

Ed McCabe: Now, the TSLAQ part, I agree with you. It's some of the most impressive ... it's the first crowd source resource project I've ever seen.

Mike Alkin: Yep.

Ed McCabe: And it's very much peer leading. So you'll see a guy, you can tell, a very smart lawyer with a, in my eyes probably a small mistake, and he'll politely, by and large, be corrected on that. So if you're gonna go out on TSLAQ and you're gonna say something, it needs to be credible. You know, I mean yeah everyone does their trolling from time to time, but that's not what really what it's about.

Ed McCabe: So really what we had done was ... if you were a buy side analyst and you covered this company, [inaudible 01:17:59] could be a very good analyst, you need to wear a lot of hats to be a very good analyst. But it's very hard to be expert in all the disciplines required. It's impossible. So there are guys on TSLAQ who have legal backgrounds. There are guys on TSLAQ who have auto manufacturing backgrounds. There are guys-

Mike Alkin: Distressed backgrounds you see, yep.

Ed McCabe: Distressed backgrounds. I mean, you know, and so that crowdsourcing effort is something Musk couldn't have foreseen, and it's more powerful than he could've ever foreseen, and most of the guys are anonymous. Which ... for reasons that make sense to me. All you have to do is read them and know they're credible.

Mike Alkin: Well that's it, and that's where you talked about the financial numeracy. And look, a retail investor, I get it. They don't know. That's not what they do for a living, but if you are financially numerate, and you are a financial analyst, and you read this work, it's hands down spectacular. Yet it gets dismissed as FUD, right? I forget, what does FUD stand for again? I forget.

Ed McCabe: Fear, uncertainty, and doubt.

Mike Alkin: That's right. Fear, uncertainty, and doubt. It's just ... And then you have other financial quote advisors who appear on TV all the time who seem like meme accounts on Twitter that're just out there, but they reach tens of thousands of people. And it's just the craziest company story I've seen in many many many years.

Ed McCabe: It's the craziest, and like I said I saw the dotcom bust. I've lived through Enron. I lived through WorldCom. So all the stuff we've seen, and the one thing that's different about Jeff Skilling or Bernie Ebbers, Kozlowski, or any of these guys is that they were not celebrities and household names until their companies collapsed. Then they became more infamous and famous. But

what's different here is [inaudible 01:19:58] stock from under immense pressure which I think it's destined to do, is that this guy truly was ... He transcends financial markets, and he is a celebrity, and he's known in almost every household in this country and around the world, and that's a very different place to start from than anything I've ever seen in terms of the arc of the story.

Mike Alkin: And he's created this us against them fear where people want him to win.

Ed McCabe: Listen, it's either big oil or its traditional auto manufacturers or it's short sellers or it's a saboteur, and you know what it'll be this time? And I don't even know if he may be trying this which is suicide by cop to me, just taunting the SEC so that when they ask him to exit, he can say, "Well I was working to sustainable transport. I was working to help save the earth, and this big bureaucracy screwed it up." And that's ... because that is his psychology, and I'm not a psychiatrist or psychologist, but you watch somebody long enough, and this stuff is repeated behavior, and so anyway there's always somebody else. It's never the fact that the manufacturing lines weren't tested. It's never the fact that the car wasn't tested. It's never the fact there weren't enough service centers. It's never the fact that there weren't enough superchargers. It will always be somebody else, a third party, and outsider, someone working against him that caused this that does not work.

Mike Alkin: Always blame the shorts. Which, as a short seller, and I know, that when you hear that your ears perk up. Because how many companies in your career, and I know I've seen it, where there are some short cases against them and management ignores them, and they go about their business and they put up the numbers, and they don't even acknowledge it.

Ed McCabe: Yeah, you know I think it was several years ago that I think it was Whitney Tilson who I think wrote a very polite and thoughtful letter or a blog or something for chiefing Netflix.

Mike Alkin: Reed Hastings, he sent it, right? Yeah, yeah.

Ed McCabe: And Reed Hastings I think responded. I forget, responded on a call, and referenced it, but politely said, "So here's how we're gonna address this issue, and-"

Mike Alkin: He handled it so beautifully. He said, "Here's where I think you're wrong," but that was it.

Ed McCabe: Now I can recall Jeff Skilling calling an analyst on a conference call an asshole. I can recall ... Excuse my language, but that's the exact quote because the guy asked why he doesn't print a balance sheet with his earnings report, which is a fair question. I watched Musk [inaudible 01:22:34] YouTube because the first question was about whether orders were being converted into configurations for the car, and the second question was about capital needs. He found those questions offensive and immediately went to a 24 year old kid on YouTube.

Ed McCabe: You know, when I start to see that thin-skinned behavior, and I see somebody who's obsessed with the shorts, [inaudible 01:22:58] about the shorts. That's, for me, and if you're an experienced short seller, those are the types of indicators that we catch your ear and cause you to dig in a bit more. I think that is the case here.

Mike Alkin: Well, you know, you know it. Where there's smoke. So.

Ed McCabe: Yeah, and listen, the seminal ... There's gonna be a couple seminal moments when the post-mortem is written here, and the first one is gonna be collecting half a billion dollars of deposit, interest free loans, for a car that still isn't really being built. That's unbelievable to me. I saw some analysis, and I've done a lot of analysis on this, but I hadn't looked at the numbers report. Since 2008, 70% of the cashflow from operations for this company had been from deposit.

Ed McCabe: So here we are in 2019, in 11 years, 78%, and basically what you do is you take the deposits for the next thing and you use it to build the current thing, and then when the current thing is waning then you announcing another thing, and that's what we saw the Model Y less than kind of likelihood.

Mike Alkin: Huh.

Ed McCabe: It's an amazing number to me. 78% of all cashflow from operations.

Mike Alkin: So you use the money from one thing to do something else to ... Oh okay, I-

Ed McCabe: You've heard of that. And so when do you run into a problem with that model? You run into a problem with that model when the growth starts to fall. And when the demand for the product ... when the Model Y doesn't deliver deposit like the Model 3 did, and-

Mike Alkin: Well its money, right, growth is the great elixir in many instances until it's not.

Ed McCabe: Absolutely. The thing that with this working capital cycle, you know, where you're running a network in capital deficit, you're able to extend payable until the growth reverses, and all of a sudden the bills from last quarter come due, but the incoming cash from the incremental sale was not as high, and forget about the long-term liabilities for this company, which are gigantic. Some quantifiable, some unquantifiable. But just in that working capital deficit, whatever's this 3.4 billion dollars of payable and $2.1 billion of approved liabilities, and then a cash balance where $972 million or something like ... $792 million, I'm sorry. Close to $800 million dollars, our customer deposit. You know, that's not a permanent source of capital.

Mike Alkin: No.

Ed McCabe: That's either money that should be being put toward a product or, to me, should've been held in [inaudible 01:25:37] or in a restricted cash balance for the possible refund. So the liquidity-

Mike Alkin: So with that, I mean, okay so maybe retail investors don't see those liquidity issues and short sellers do. Certainly suppliers have to understand. It's their cash they want and that they're committing credit to these guys. What do you think is happening in Panasonic and other major suppliers to the company? We knew he went back to them in July, I think it was reported like you said earlier. At what point do we start to see the creditors say no mas?

Ed McCabe: Yeah, you know, I think-

Mike Alkin: And suppliers, I mean.

Ed McCabe: Prisoner's dilemma. I mean, a company has $18 billion to purchase obligations. Almost ... the vast, vast majority of ... with Panasonic. And if you looked at the 2017 10K, you would've seen the purchase [inaudible 01:26:35] is at 2.8 billion. If you're looking at ... You would've seen 2.3 billion dollars. In 2017, that 10K, you would've seen a purchase obligation for 2019 at 2.3 billion. But the latest 10K, the purchase obligation had jumped to 4.9 billion. So why is that happening?

Ed McCabe: Well, we could just speculate, but since we think that they got rebates and discounts that Panasonic and other suppliers said, "Okay, you had this purchase obligation of x for me 2019. I'm

gonna give you a break on 2018, but we're gonna push down into 2019." And that's a hell of a big jump. Is the purchase obligations for the same year.

Ed McCabe: And then Panasonic's ... I think they probably still are, that their head of auto I think it is.

Mike Alkin: Yes, yep.

Ed McCabe: Recently. He resigned. And you know, and if you look at the quarter for Panasonic that was concurrent with the miraculous quarter for Tesla, the business for Panasonic was terrible. So in the most profitable quarter for Tesla, Panasonic had a bad quarter which is an interesting ...

Mike Alkin: Doesn't match. Doesn't square, right?

Ed McCabe: That's the position. Yep. Said so where is Panasonic? Panasonic probably has over $2 billion invested in this plant because it's their machinery inside of it, and then you've got this, I don't know, $16 billion worth of purchase obligations that are the Panasonic long-term, and those purchase obligations are based on volumes, presumably the 5,000 a week he was gonna get to at the end of '17, and the 10,000 a week he was gonna get to at the end of '18 to the Model 3. We're nowhere near there.

Ed McCabe: So what happens there? These personal obligations are based upon projections that we're never gonna hit. Which is a real conundrum, but on the other hand, if Panasonic doesn't play ball with Tesla, they end up in bankruptcy. So I don't know exactly how this resolves itself, but people look at the long-term debt, and you just talked about the network and capital deficit, but this purchase obligation could be the biggest issue [inaudible 01:28:44].

Mike Alkin: Yeah. No, I agree with that. Ed, I can't thank you enough. It's really been a pleasure speaking with you. Anything you think that we didn't touch on that you wanna talk about about it?

Ed McCabe: Yeah, you know, it's funny. I'll leave you with three quotes that I think are ... I'm gonna read 'em to you. One is related to ... it's from the ... anyone who wants to understand Musk and his background and this company, there's a biography by Ashley Vance, is the person's name, and it definitely is evenhanded. I'd say probably airs on the side of being more positive, but it does give you a good insight into, or a good look, into Tesla's personality.

Ed McCabe: So in 2008, Kimball had this comment about his brother and the deposits they were taking for the Roadster, and this was referring to Elon using Roadster deposits to keep the company going. And this is what Kimball said, "It just seemed like, 'holy shit, this thing is going to crater.' I was close to bankruptcy [inaudible 01:29:54] personally. But then he said, 'I'm sure Elon would have found a way to make things right, but he definitely took risks that seemed like they could have landed him in jail for using someone else's money.'"

Mike Alkin: That's a quote?

Ed McCabe: That's a quote in the book from Kimball about his brother. And obviously it tells you something about Musk's personality that he would take that risk, and that his brother thought that risk was so serious that it could end up criminal. And I'd also like to [inaudible 01:30:23] in there, it's very much how we get view of Musk, I'm sure Elon would have found a way to make things right, and I think that's one of the big problems with this story. If an ends justifies the means. So if the end is to save the planet, and you're one of those people who that's very important to, you don't care how Elon does it, and frankly he doesn't care how he does it. And that's why I think you see a lot of these behaviors.

Ed McCabe: Another one, you may have seen this, he was asked to comment ... Musk was, Elon, about Solyndra. Solyndra went bankrupt and defaulted I think on a department of energy loan. She left a comment on the whole debacle, and said, "The most you could say that Solyndra executives were too optimistic. It presented a better face to the situation and should have been presented in the final few months, but then since they didn't do that, it would have become a self-fulfilling prophecy."

Ed McCabe: So as soon as the CEO says, "I'm not sure, we'll survive," you're dead. So you think about what appearance [crosstalk 01:31:25] keeping up is that was his mentality on Solyndra, and here's the final one, but this is from Jane Stewart who had that article ... He had that interview in The New York Times with Musk right around funding secured, and Musk was very emotional, moved to tears during the interview, and this is what he said:

Ed McCabe: "I thought the worst of it was over. I thought it was," he told the paper. "The worst is over from a Tesla operational standpoint, but from a personal pain standpoint, the worst is yet to come."

Ed McCabe: Well, I don't believe the worst over at from a Tesla operational

standpoint, but I think his second statement about what might come for him personally might prove to be prophetic.

Mike Alkin: Very interesting. You know, for me I would recommend people read the book Tucker, about the Tucker automobile. You know, when I see these reveals on the Model Y, and the other stuff, just read the book. It's right out of a playbook that's 60 years old, 70 years old. It's a fascinating read.

Ed McCabe: Did you watch the [inaudible 01:32:28] documentary last night?

Mike Alkin: No, I didn't.

Ed McCabe: That book, Bad Blood, is very good too. I'm not saying they're perfect parallels, but there is that fake it 'til you make it mentality which like I said, you can take [inaudible 01:32:41] all for a company, and take toward an internet company, but you can't take it toward a healthcare company, and you can't it toward an auto company because lives are at risk.

Mike Alkin: Yeah. Well it's that they say history doesn't always repeat, but it often rhymes.

Ed McCabe: It often rhymes.

Mike Alkin: Often rhymes. And thanks, I really appreciate it. It was great having you on.

Ed McCabe: Oh yeah, it was a pleasure. Thanks for having me on.

Mike Alkin: Well I hope you enjoyed listening to my chat with Ed. Really thoughtful, smart guy. Yeah I know. Tesla [inaudible 01:33:10]. We don't get it and don't understand it, Elon's god, I get it. Spare me. Don't send me the email. I get it.

Mike Alkin: So anyway, I always enjoy talking to guys who really do a deep dive on their research and you never know what you're gonna learn. We'll be back next week. Look forward to speaking with you then, and have a great week. Thanks.

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