Basis Points – September 20, 2018

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Above the Fold

- Shares of Tesla declined 4 percent on Tuesday after the company revealed that the Justice Department requested documents last month regarding CEO Elon Musk's August 7 tweets that the company would be taken private, with "funding secured." The Justice Department is running the criminal probe of Tesla in conjunction with a civil fraud probe by the SEC. Musk had been taunting short sellers of his company's stock all summer, blaming them for driving down the company's shares. Tesla is the most shorted stock in the S&P 500.

- The White House added $200 billion in Chinese goods to the list of products that will be slapped with tariffs of 10 percent, with the tariff rising to 25 percent at the end of 2018. This escalation of tariff rates is seen as a negotiation ploy to force China to settle the larger trade and tariff war after the mid-term elections, and before the end of the year. The market seems to be shrugging off the continuing ratcheting up in the value of products subject to tariffs, as the combined effect of all the tariffs announced so far is only 0.32 percent of total U.S. GDP. With such a strong economy, a cut in GDP growth from say, 3.5 percent to 3.2 percent may cause much less angst than it would have three years ago, when GDP growth was only 1.5 percent.

Three Things

- The holiday shopping season is still two months away, but retailers faced with record-low unemployment rates are starting their holiday hiring season earlier than ever, as they scramble to find workers for their stores. Retailers are being forced to compete for an ever-dwindling number of people that want to work part time during the holidays, and are offering perks such as higher wages, profit-sharing payments, bonuses and paid time-off to attract workers. Around the U.S., 757,000 retail jobs were open in July, about 100,000 more than a year ago. Kohl’s and JCPenney began hiring seasonal workers in June, about three months earlier than normal years. Delivery companies like UPS and FedEx will also be hiring and competing for a large amount of workers for the holidays, as online shopping only grows more prominent every year.
- Cristiano Ronaldo, the Portugese Real Madrid soccer star and one of the world’s best known celebrities, commands the highest payment per Instagram post for a male. Selling posts on the Instagram photo-sharing app is huge business these days, especially when it comes to promoting products, celebrities and the products that celebrities are using. Ronaldo earns $404,000 from an advertiser for each Instagram post he makes. The only other people commanding higher rates are Kim Kardashian, at $505,000, and Selena Gomez, at $557,000. You could argue that these fees are a bargain for an advertiser. Ronaldo has 115 million Instagram followers, who will immediately see his post and the product he is touting. Compare that with a TV commercial during the Super Bowl, which costs $3 million for 30 seconds. While viewership is huge for the big game at 103 million people, very few of these viewers are in any one company’s target market, so the cost is wasted on most viewers. The commercial is also gone after 30 seconds, and many people at Super Bowl parties are not watching the commercials anyway. A post from Ronaldo may be expensive, but advertisers are assured of reaching a very targeted group of consumers who like, follow and trust him. The fee may, in fact, be a cost-effective way to reach and connect with this huge group of consumers.

- Flexible workspace demand is surging in this very strong economy, and WeWork now occupies more Manhattan office space than any other company. WeWork is a “co-working” company that rents 5.3 million square feet of office space in Manhattan, and many other cities. Small and midsize businesses love the flexibility that renting small lots of office space offers, as leases can be as short as one month or up to three years. WeWork has accounted for 10 percent of all new office leases signed in New York City this year. While tenants have great flexibility to move in and out as they please, the co-working company signs a normal building lease for 10 to 15 years, so are on the hook for payment even if the economy falters. A similar company, Regus PLC, declared bankruptcy in 2003, after they leased a huge amount of office space during the dot-com craze, and then struggled to re-lease space after the tech market crashed.

Did You Know

Tesla may be in hot water with securities regulators, but the problem with Tesla stock, however, is not short sellers. The problem is not a brilliant but bombastic CEO. It is not the uniqueness of the technology, or consumer adoption of electric cars. And it is not about production execution success or failure. The problem for the stock is that even if Tesla’s business succeeds, it is an auto manufacturer. It is not a technology company, it is an auto company.

Auto manufacturers are very cyclical companies, and that cyclicality is reflected in their customarily low earnings multiple valuations. Ford has been in business for 100 years, it is profitable, and sold 6.6 million vehicles last year. But its stock sells for seven times earnings. General Motors is similarly profitable, and sold 10 million vehicles last year. GM stock trades at six times earnings. Tesla sold 150,000 vehicles last year and has a production schedule to sell 250,000 over the next year. Tesla is not profitable at this time, so the stock does not have a price-to-earnings multiple, as there are no earnings. But ironically for a Tesla stockholder, the worst thing that could happen would be that Tesla becomes profitable. When Tesla begins making a profit, it will be valued with an auto manufacturer p/e multiple, which would presumably lead to a much lower valuation than the current pie-in-the-sky market cap of $50 billion. Especially with much larger companies like Ford (market cap $38 billion) and GM ($50 billion) selling many more vehicles with far greater profitability than Tesla. Even with amazing technology that could change the world, if your product has a steering wheel and rolls, you are an auto company.

As a side note, Elon Musk seems to be obsessed with crushing the short sellers of his stock. But what is the best way to beat short sellers? You run your business. You grow your business. You execute your business plan, and generate strong earnings. And you create great products that customers love and can’t live without. Do these things, and every spat with short sellers will take care of itself. Short sellers are actually doing your company a favor, by creating lots of future demand for your stock. After your company proves successful, the shorts will be forced to buy back stock to cover their shorts. So one second focused on those that are negative on your company and its prospects is one second wasted from your focus on growing a great company. And villifying short sellers takes employee attention away from growing a great business, if they feel that wolves are constantly at the door. If employees believe that the future of the company is in their hands, then they will not waste precious time worrying about short sellers. Shorts can write negative reports. Shorts can go on TV and state their case. And shorts can go to conferences and tell a big room of investors why a company will go bankrupt. But shorts cannot affect how you plan, execute and grow a company. Shorts cannot hurt a company's current business and future success, unless a management team allows them to.