Rodney's Take

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Warning to Tesla: Objects In Mirror Are Closer Than They Appear

I loved The Far Side, the mostly single-panel comic written by Gary Larson. He took a break for a number of years but has since returned and is churning out comics again. One of my favorites shows a woman looking into the side mirror of her car, which has a giant, scary eyeball in the reflection. On the mirror is the standard message, "OBJECTS IN MIRROR ARE CLOSER THAN THEY APPEAR."

As we make our way through 2021, this particular comic comes to mind, but not because of monsters on the road. Instead, I'm thinking about Tesla. The front-running electric vehicle (EV) maker should be very concerned about competitors, which suddenly seem much closer to catching up. If competitors do catch up with Tesla, the carmaker's stock could become a drag on the portfolio of many investors, even if they don't own Tesla directly.

I've been writing for several years that Tesla eventually will face stiff competition from existing carmakers, which likely will overwhelm the tiny company. It might seem odd to think of Tesla, which has a $640 billion market cap, as tiny, but the firm makes only about a half million cars per year, whereas global output is just under 100 million. Volkswagen produces more than nine million cars per year and Ford and GM each produce several million per year, yet Tesla is worth more than all three companies combined.

That could change quickly.

The U.S. had 15 EV choices last year. By the end of this year, we'll have almost 70. Volkswagen just started selling its ID.3 and ID.4 EVs, and already the company projects that it will sell more battery-only EVs than Tesla by 2025. Volkswagen sold 230,000 battery EVs last year, half of what Tesla sold but 214% more than VW sold in 2019. VW is growing its EV business at light speed.

There's no question that Tesla builds an incredible software/equipment interface that parades around as a vehicle, but the company is missing something that the legacy car companies have: scale.

It will be very difficult for Tesla to create new manufacturing capability fast enough to keep up with Volkswagen and other legacy producers who can shift manufacturing from one type of vehicle to another. That doesn't mean transitioning from producing an internal combustion engine (ICE) to an EV is easy, but it's a lot simpler than building a new factory, developing the supply chain, and working out the kinks.

I've written many times that Tesla has never earned a nickel of profit by selling cars. The company sells emission credits to other car companies, which account for all of Tesla's profits so far and then some. The firm currently trades at a price-to-earnings ratio of just over 1,000. If cracks start to appear in the business model and investors get nervous, the stock could fall very quickly.

That might be a bigger problem than many investors realize.

Standard & Poor's added Tesla to the S&P 500 Index last year, which is weighted by market cap. Tesla is the seventh-largest company in the index and composes 1.6% of the basket. If Tesla tanks, it will act as a drag on the S&P 500 and pare the gains of index investors far and wide.

It's an interesting paradox that the problem eventually cures itself. As Tesla's value shrinks, it puts negative pressure on the index. But the more it falls, the less pressure it exerts, as it becomes a smaller percentage of the index. While mathematically correct, that fact is likely to be cold comfort if we watch Tesla crash and burn this year, pun intended.

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Got a question or comment? You can contact us at info@hsdent.com.