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WANG v MUSK

On my first trip to Japan back in 1988 I was given a tour of a Nissan factory just outside Tokyo. Over my many subsequent trips, I managed to get tours of Toyota, Honda, Mazda and Daihatsu factories and I even managed to get a tour of a Hyundai factory on a trip to Korea. In addition to the car assemblers I also visited companies that were dependent upon the car industry, companies like Yokohama Rubber for tyres, Aisin Seki for components and Tachi-S for car seats. Other companies I visited, like the steel and glass companies were dependent on the car companies for some of their revenues.

Having visited all these car and car related companies it became clear to me that this was an incredibly tough industry, an industry where the competition was so intense that it was highly unlikely that any mass market company would be able to sustain high returns on invested capital. In other words, I began to realise why Warren Buffett didn't have any money invested in the sector. I therefore decided to reduce the amount of time I devoted to researching the sector and focus my attention on other sectors where there was a greater chance of finding companies that could develop sustainable competitive advantages.

In 2008 however, for the first time in perhaps ten years, I did pay attention to the car industry when Berkshire Hathaway invested in Chinese battery and electric car company BYD. Naturally enough I was curious to understand why this investment had been made. A 2009 Forbes article gave me some insight into how it had come about:

In acquiring a stake in BYD, Buffett broke a couple of his own rules. "I don't know a thing about cellphones or batteries," he admits. "And I don't know how cars work." But, he adds, "Charlie Munger and Dave Sokol are smart guys, and they do understand it. And there's no question that what's been accomplished since 1995 at BYD is extraordinary."

This extraordinary achievement at BYD was all down to its founder Wang Chuanfu and this is what Charlie Munger is on the record as saying about him:

Wang "is a combination of Thomas Edison and Jack Welch – something like Edison in solving technical problems, and something like Welch in getting done what he needs to do. I have never seen anything like it."

Coming from Charlie Munger that is praise indeed and certainly helped me to understand why Warren Buffett was prepared to break his own investing rules. He backed the person and that told me everything I needed to know.

Naturally enough I thought about whether I should also back Wang but one quick look at the share price brought out the cautious side of me because any company where the share price doubles, triples, quadruples in a short space of time is generally too speculative for my liking (see share price chart below). When I see that kind of share price movement, I generally don't bother doing any further research. I just move on to something without the same mania attached.

BYD Share price from 2008 to 2010

For the next few years, I once again gave very little attention to the car sector and Wang Chuanfu. It took another larger than life character to get me to take notice.

I don't remember when it was that I first heard the name Elon Musk and to be honest I'm pretty sure I didn't give it much thought at the time. A small electric car company, Tesla, just didn't get me that excited and didn't result in anything more than just a passing thought.

It was only after I attended an Investec seminar in October 2017 that Tesla really jumped out and into my focus. A presentation given by Tom Slater, a fund manager at Scottish investment partnership Baillie Gifford, highlighted how in his opinion Tesla was one of those few extraordinary companies that transform an industry. He spoke about how they had become one of the biggest shareholders in Tesla based on a belief that Elon Musk was one of those exceptional leaders.

The whole Baillie Gifford approach to investing, trying to identify and acquire meaningful positions in the small number of truly exceptional companies is an approach that I'm naturally attracted to but my initial reaction to their commitment to Tesla was one of disbelief. I found it incredibly hard to believe that all the other large car companies would stand by and not respond. I thought that BMW, Audi, Mercedes, Toyota, Volvo etc would develop electric cars that would be equally as good as anything Tesla produced. I also remembered that ten years earlier BYD was regarded as the electric car company founded by an exceptional leader that was going to transform the industry.

I started reading articles to help me get my head around what was going on.

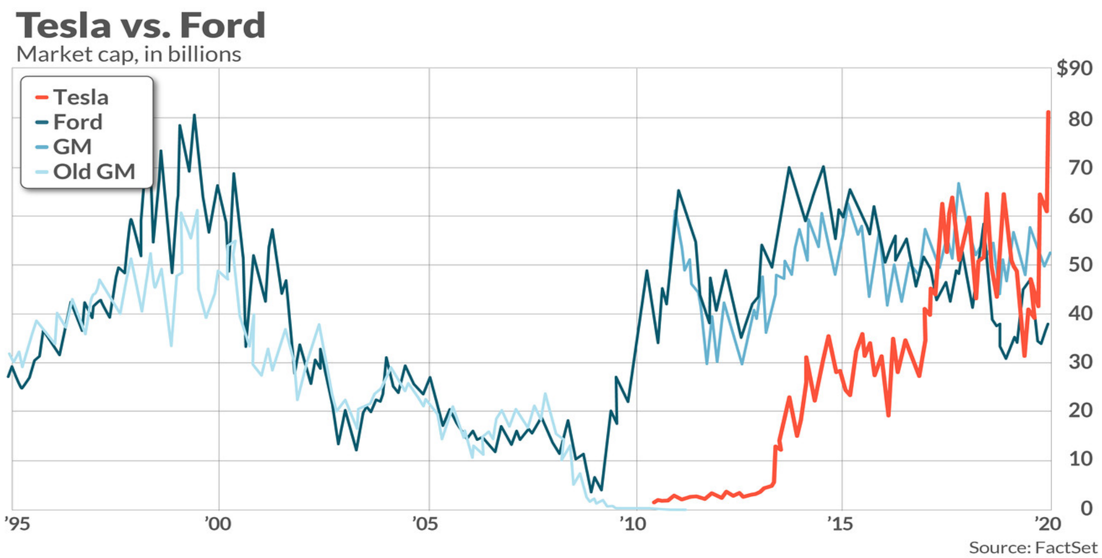
I soon realised that battery technology was the most important thing determining the medium term success or failure in the electric car industry. A few articles later and I even started to wonder whether there would be a shortage of Lithium to produce all those Lithium-ion batteries or might there be a shortage of Nickel if Nickel Metal

Hydride battery technology improved……numerous questions with plenty of uncertainty about the answers!

I did not read anything to make me believe that this most important factor, the battery technology, was at that stage in any way uniquely solved by Tesla. They may have developed a relationship with Panasonic to build the biggest Lithium-ion battery factory in the world and that was therefore an important head start but I was also reading that there was plenty of competition from Chinese and Korean companies that would be more than willing to sell to the other car companies. Companies like LG in Korea had a reputation of being fierce competitors.

I was therefore confused as to why Tom Slater / Baillie Gifford were such believers in Elon Musk. Luckily, I heard about the New York Times bestselling book by Ashlee Vance that gave the impression it might give me an insight into the man. To summarise the book in one paragraph is impossible so I highly recommend the book for anyone that has any sort of interest in Tesla. I would, however, like to say that I found the whole history of SpaceX to be an incredibly powerful story. To have achieved what he has achieved at SpaceX is pretty incredible stuff and certainly helped me to understand why Baillie Gifford were prepared to back him.

It is one thing to be aware of the creativity of Elon Musk and of the possibility that Tesla might become the largest electric car company in the world and also to be aware of the possibility it might lead self-driving technology and ultimately believe it might become in effect a software company but it is a completely other thing to put my own money on the line and say that I am prepared to invest in the company. What price was I willing to pay for that potential? This is where my cautious nature becomes a feature of my investment philosophy. I just struggle to take that giant leap of faith that Baillie Gifford took because from the time I first had a look at Tesla (back at the end of 2017) it has been valued based on the assumption that it will be a phenomenal success. At the end of 2017 Tesla had a market capitalisation of over $50bn (see the Chart below) and that was for a company that delivered just over 100,000 cars that year. Clearly Tesla was being valued by its long-term potential rather than its recent production because a value of $500,000 per car produced was obviously not what Tom Slater was using! My crystal ball is a bit fuzzy at the best of times and I am nervous making the type of assumptions necessary to justify paying that price. I therefore did my usual thing and put Tesla in my "too difficult" to value file.



 Ever since that initial look at Tesla in 2017 it has remained in that "too difficult" to value file and I have watched with a certain amount of jealousy as Tom Slater and the Baillie Gifford team have generated great performance as the share price has gone higher and higher.

Tesla Share price chart for the last 3 years.

 This brings me up to the present day and brings me to the point where I have to explain why I have only now decided to write about Tesla and BYD. Two things happened recently that really got me thinking.

 Many people have heard the Joe Kennedy "shoe shine boy" story- the story about the shoe shine boy that was giving stock tips just before the 1929 Wall Street Crash which Joe Kennedy took as a sign that the market had become too speculative. Well I have recently had two Joe Kennedy moments.

 First of all, my eldest son asked me why I had not bought Tesla and he asked me in a sort of way that suggested that he was beginning to doubt that I knew anything about investing! (He has asked me the same about Apple and I have desperately tried to defend myself by saying that Apple is the biggest holding in the Berkshire Hathaway portfolio).

 Secondly when I was talking to a few friends over a nice meal after a game of golf, one of my golfing buddies told the story about how he had been given a tip earlier this year to buy Tesla. Being the cautious individual that he is, he decided to talk to another friend of his that he described as a financial professional. He said that his financial professional friend had given him a list of reasons why he should not invest in Tesla and therefore he had taken the advice and not invested. (I was sitting there thinking how glad I was that he hadn't asked me because I would have given the same advice!) He then threw his eyes to heaven and made that sort of dismissive remark that made it clear that he now holds financial professionals in the same regard as he does economists!

 I get worried when my son and golf buddy think it is so obvious that Tesla is a buy. Such bullish sentiment brings out the Joe Kennedy contrarian in me or as Howard

Marks would say, it's time for some second level thinking. As creative as Elon Musk is, he is not the only innovator competing in the space.

All this exuberance with regard to Tesla motivated me to go back and catch up on what had been going on at BYD. To bring myself up to date I had a look at their 2020 interim report. Here is an interesting section from that report:

In March 2020, BYD released and mass-produced its next-generation battery product, the "Blade Battery," which redefined the safety standards for new energy vehicle industry by passing the nail penetration test, the so-called "Mount Everest" in the respect of safety testing for power batteries.

Clearly BYD are still in the race. I'm therefore going to stick my neck out and suggest that over the next ten years (my definition of the long term) Tesla will underperform Berkshire Hathaway and the world index. I'm not suggesting that anybody short the shares, I'm just saying that if I was Baillie Gifford I'd be locking in a chunk of my gains.

I will hopefully get the chance to write another opinion piece in 2030 giving an update on whether this prediction comes true even though there is a good chance my son might own a Tesla by the time I get to write it. (Knowing him he'll just do it to mess with my head!)

Watch out Elon, here comes Wang Chuanfu (with Charlie, Warren and Bill).