

Tesla is Using Nortel's Business Plan (that's not a good thing)

written by Peter Clausi | July 25, 2018

Those who don't learn from history are doomed to repeat it, so let's use Nortel's history to learn why Tesla, Inc. may be about to drive itself into deep trouble.

If you're reading this, you've heard of Tesla. It has been a stock market marvel. The past five years have seen wealth created for long-holding shareholders – 5 years ago, Tesla was trading around USD\$45 a share, and today it's around \$297. The chart from Nasdaq shows for the last year Tesla has been the poster child for “choppy”, as its stock price has oscillated with amplitude between \$390 and \$245 per share.



Tesla's PromotionMachine has been sleeping at the factory trying to convince the investing public that revenue and earnings will ultimately catch up with the stock price. Bears and shorts are convinced the last part of that sentence is backwards.

Tesla is at a difficult stage of its existence as it tries to go

from start-up to establishment. It needs to show the doubters that it has revenue, that the pre-orders for the Model 3's are not being cancelled and are actually being converted to sales, and that the Holy Grail of positive cash flow is glowing in the road ahead. The latest Q2 was Tesla's most productive in its history.

The problem is, Tesla has had and continues to have horrific issues on the shop floor. Production, while up, remains far behind the original and the revised targets. Panasonic and the [Cobalt Cliff](#) have something to do with this, but Tesla has acknowledged the production failures are mainly a function of over-automating the shop floor to a point of unmanageability.

Tesla and its CEO Elon Musk need this year to be an operational success. The company can't run forever on champagne wishes and caviar dreams. It must show Wall Street and the global green investing community that it can dent the Detroit Big Boys, it can take a run at Honda and Toyota, that German engineering is secondary to American gee-whiz know-how.

Litigation lawyers will tell you when the facts are against you, pound the law. When the law is against you, pound the facts. When the facts and the law are against you, pound the table. Tesla looks like it's opting for the table pounding.

The Wall Street Journal [reported recently](#) that Tesla, "has asked some suppliers to refund a portion of what the electric-car company has spent previously". WSJ also reported that Tesla confirmed it is seeking price reductions from suppliers for projects, some of which date back to 2016, and some of which haven't been completed.

Did we mention that Tesla is [burning through](#) about USD\$1,000,000,000 per quarter, with only about \$2.7B in the bank ? And don't look at the convertible debt pricing issues lurking

over the horizon...

What Tesla needs is a much higher stock price, for the inevitable equity financing and to help with those pesky convertible debt problems.

Bring Nortel back into the picture. Visit the [Wikipedia page for Nortel](#) for links to the painful facts below.

Nortel Networks Inc. (then called the Northern Electric and Manufacturing Company Limited) was partially spun out of a predecessor to mighty BCE Inc. in 1895 (yes, 123 years ago), and completely spun out from BCE in the internet madness of the year 2000. It was a huge financial win for BCE. Nortel ultimately made equipment for the heavy-breathing internet industry – switches and multi-protocol optical networks.

Nortel was a strange chimera, a combination R&D – manufacturer – vendor; much like Tesla is today. The hype machine was running well ahead of the financial statements as the company was worth roughly one-third of all companies then listed on the Toronto Stock Exchange.

You remember what happened next, right?

Sufficient cash flow and revenue failed to materialize. Nortel's market cap went from close to \$400B to only \$5B, and ultimately Nortel filed in court in Canada and the USA for protection from its creditors. Goodbye, over 95,000 jobs worldwide.

The bankruptcy process ended in 2017, by when over \$2,000,000,000 had been chewed up in the process, including legal fees.

Prior to bankruptcy, one of Nortel's operational problems was negative cash flow. Despite growing revenue, over the years its cash flow never did catch up to the expected glowing future and

the soaring stock price. The car-wreck crash in the stock price, followed by the creditor protection process, were reflections of that failure.

Nortel's management team used every tool at hand to bring new revenue onto the P&L. Some of those tools could not be used today under new accounting standards such as under [IFRS 15](#). Back then, one of the tools available to increase revenue was to vendor finance its own customers.

That vendor financing worked like this. Internet usage was booming, so websites and networks needed better equipment capable of processing the growing loads. Nortel and its advanced optical technology were the solution, but the equipment was very expensive. Not many start-ups had \$10M to spend on a network switch, but without all those start-ups buying equipment Nortel couldn't hit its targets which would have lead to a cratering of its stock price.

Nortel's fix was to finance those start-ups and deliver the switches before receiving full payment. In some cases up to 80% of the purchase price was financed, which meant Nortel was using its working capital to sell at a loss to gain future cash and to buttress the current revenue number.

As always, after the boom comes the bust. Internet stocks tanked in 2000, killing many of Nortel's customers and wiping billions in financing off Nortel's financial statements. The cash flow that seemed so clear just months before failed to materialize, eventually taking Nortel into the sad tale of creditor protection.

Nortel, like Tesla, artificially distorted its own business model by causing elements in its supply chain to finance its activities. Nortel used its clients, Tesla is using its suppliers.

Tesla declined to provide the markets with a copy of the recent memo but confirmed it is seeking price reductions from certain suppliers for historic projects, some of which date back to 2016, and it is engaged in discussions concerning future pricing based on production ramp-up.

The automotive industry is a highly competitive margin-driven business, and Tesla is looking to save a buck / make a buck anywhere it can, as it should. While it's true that ongoing discussions with Tier 1, 2 and 3 suppliers are common, asking suppliers for cash back is closed-system cannibalistic behaviour, and reeks of desperation. As Tesla's cash dwindles and its options slowly disappear, Tesla must fix its manufacturing issues and create real value by executing on its business plan, not by parasitically sucking cash out of the system by draining its suppliers.

Nortel taught the lesson. Will Tesla learn from it or repeat it?