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Silly season – determining value in a mad, mad world

One of the many unpleasant things about the ageing process (and believe me, there are plenty) is that the question “Is it just me, or has the world gone crazy?” is something that crops up with alarming regularity. It can be raised in connection with any number of topics, but it is only once in a while that relative values of publicly quoted companies come under this spotlight.

In the olden days, companies were valued on the basis of the likelihood of receipt by an investor of a steady stream of growing dividends. Profitability was important, because it would be the propellant behind not only growth in dividends, but also growth in the capital value of the enterprise. In a nutshell, a cornerstone of capitalism.

We are now, however, living in a rather different world. Despite the fact that the investment industry houses probably more than its fair share of highly intelligent and clever people, these old-style methods of company valuation are seen as frightfully old hat. We all know this has been the case in some disrupted sectors such as tech, but it is becoming more widespread.

Take General Motors (GM) and Tesla, two broadly similar businesses in terms of what they offer the general public. GM employs 200,000 people across dozens of plants, builds over ten million cars and trucks every year, and has a strong balance sheet with $20 billion in cash. Tesla has one plant, employs 33,000 people, and sold about 100,000 cars last year, and has a little over $2 billion in cash. Tesla’s burn rate of cash is a whopping $1 billion a quarter, which even for billionaire (sorry) Elon Musk is a lot of money. When it comes to automobile manufacturing, size really does matter: GM makes 20% of all the cars on the planet. Tesla makes less than 0.5%.

And yet: the market capitalisation of GM is $52 billion. The market capitalisation of Tesla is $64 billion. And Mr Musk has stated just this week that his business is undervalued. His possible offer to take the company private again suggests a value in excess of $70 billion. It would also put an end to all those pesky questions from analysts at shareholder meetings.

Tesla's disciples will be quick to say that these relative values reflect the future, when the auto manufacturing landscape will look very different. However, whilst it may be tempting to say that GM is an old fashioned business making old fashioned cars, which will all be illegal in 20 years, this is simply not the case: GM is already testing its all electric Chevy Bolt (cool name, anyway), which is capable of navigating complex urban streets unaided by humans, and could be with us in only a couple of years' time. By 2023, GM believe that they will have more than 20 electric models available. Tesla might appear to be the pioneer, but if we are still talking about the old days, it was the pioneers who tended to get scalped.

So where will the kings and queens of the automobile industry reside in 20 years' time – Detroit or Silicon Valley? It's too early to tell, but it is probably too soon to write off the world's giant auto manufacturers just yet.

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