

June 26, 2013

Max Boot starts our look at diplomatic humiliation.

Forget “Where in the world is Carmen Sandiego?” The hottest real-time game in the world is: Where in the world is Edward Snowden? The rogue NSA techie—who, in the judgment of the NSA’s head, Gen. Keith Alexander, “has caused irreversible and significant damage to our country and to our allies”—has fled Hong Kong and wound up in Moscow. He was rumored to be heading to Ecuador via Havana but he didn’t make the Aeroflot flight he was expected to take, leaving a pack of journalists who bought tickets to photograph an empty seat. So presumably Snowden remains in Russia at least for the time being, with rumors swirling that Ecuador or possibly Venezuela remain his destination of choice. ...

... It may well be that case that a Republican president—John McCain or Mitt Romney—would have had no more success in apprehending Snowden, but the equanimity with which other states rebuff our appeals for his apprehension makes clear that the U.S. is suffering a significant loss of respect. Quite simply, the U.S. is no more universally loved than it was prior to Obama’s ascension—and now we are less respected too. As anyone who consults Machiavelli will know, this is not a recipe for a prince’s success.

Peter Wehner notes the failure of "reset" diplomacy.

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Add to that Putin’s support for Iran’s nuclear ambitions and his crackdown at home. (The Washington Post writes that in “an attempt to suppress swelling protests against his rigged reelection and the massively corrupt autocracy he presides over, Mr. Putin has launched what both Russian and Western human rights groups describe as the most intense and pervasive campaign of political repression since the downfall of the Soviet Union.”). Taken all together, you can see that the Obama “reset”—which at the dawn of the Obama administration was described as a “win-win” strategy for both nations—has been a rout for the Russians.

With the Snowden situation, Vladimir Putin seems intent not only defying America but embarrassing her. It turns out that an irresolute amateur like Barack Obama was the best thing that the brutal but determined Putin could have hoped for.

He’s cleaning Obama’s clock.

Power Line’s **John Hinderaker** sums up the last few weeks for the loser administration.

The goofy techie, of course, is Ed Snowden, and the question might seem hard to answer if the Obama administration’s incompetence were not on display for all to see. The international press, belatedly catching on to the fact that our president is a fool, is having fun with the U.S. Thus, Reuters headlines, with a snicker: “Questions turn to U.S. competence in Snowden saga.”

As well they might.

"The Obama administration has spent the past few weeks arguing it can wield power responsibly after Edward Snowden unveiled its sweeping spying programs. Now the administration must prove it can wield power effectively."

Well, it certainly can domestically. Not only can it sic the IRS on its political opponents, it can buy whatever votes may be necessary with other people's money. Dealing with foreign countries, where such powers come up short, is another story.

"As the 30-year-old leads the world's lone superpower on a global game of hide and seek, U.S. government officials faced questions about whether they had botched the effort to extradite Snowden from Hong Kong to face charges related to his leak of classified information."

Actually, they botched much more than that. How in the world could the NSA allow a random employee of a contractor, Booz Allen, who had been on the "job" for only a couple of months, such unfettered and apparently uncharted access to secret materials? The fact that the NSA did so is the best argument against that agency's being a trustworthy custodian of Americans' secrets.

"The latest wrinkle in the Snowden saga poses a different set of questions for an administration that has spent weeks fending off questions about whether it has abused its power to collect taxes, investigate criminal activity and fight terrorism."

*Abusive **and** incompetent! That's Barack Obama. ...*

... Barack Obama has never been a real president. He has never led. He seems to view his job duties as an unfortunate distraction from golfing and partying with celebrities. How could anyone be surprised to learn that he is an inept, ineffective president? ...

Jennifer Rubin sums it up.

President Obama's foreign policy has taken on a pathetic quality. Russia ignores us on the return of Edward Snowden and on ending the rule of Bashar al-Assad in Syria. China ignores us on Snowden and on cyberterrorism. The Taliban ignores our demands as we flee Afghanistan (including not to allow terrorists to camp out there). Iran ignores us and proceeds with its nuclear weapons program. The Palestinian Authority ignores us in going to the United Nations for statehood and then firing Salam Fayyad.

To paraphrase Robert Kagan and Charles Krauthammer, decline is a choice and we have chosen it. It is remarkable that the president thought he could continue to remain relevant on the world stage after he "ended" (i.e. abandoned) wars, slashed defense, allowed Iran to run the negotiation schedule, kowtowed to the Chinese and cut the legs out from every ally from Poland and the Czech Republic (which lost anti-missile sites) to Israel (condemning its building and making Palestinian demands on bargaining the official policy of the United States).

As Kim Holmes puts it, "Overall, the defining characteristic of Obama's foreign policy appears to be preventing overseas crises from distracting from his domestic agenda. He remains a committed liberal, at least in principle, but his foreign policy is highly influenced by political

expediency, which causes him to want to avoid risking overseas interventions.” it is not so much “leading from behind” as it is hiding under the bed. ...

For a change of pace, **Barron's** test drives a Tesla, and then test drives the stock too. One didn't fare well.

Google "Iron Man, Tony Stark" and within the first few results you'll find Websites likening that superhero to Elon Musk, 41, the entrepreneur behind PayPal, the rocket maker SpaceX, and the electric-car sensation [Tesla Motors](#). The comparison's apt. Musk is smart and stylish, and he fights planetary threats like global warming by creating spacecraft and zero-emissions cars that shame NASA and the auto giants. He's as rich as Iron Man's armored billionaire, too. Tesla shares rocketed this year from \$35 to \$115 -- lifting the Palo Alto auto start-up to a market value of \$14 billion at May's end -- before easing back to a recent \$102, where Musk's quarter-interest in the company is still worth \$3.4 billion.

It's possible to admire Musk's achievements, while still wondering if Tesla's stock market fans are viewing its prospects through 3D glasses. The towering expectations now priced into the stock don't account for the Grand Canyon leap that Tesla must make to reach its goal of cutting its car's \$90,000-plus sticker price in half. Electric-car batteries cost a heck of a lot, and today's Tesla Model S owes its better-than-200-mile range to batteries costing tens of thousands of dollars. Industries and governments around the world have spent billions on battery research, but few expect to trim electric-car battery costs by more than 20%-30% by the planned 2016 launch of Tesla's car for the Everyman. Perhaps Musk will confound the industry again, but if Tesla's next-generation car can't go the distance at half the price, its stock will head much lower.

One ingredient that fueled Tesla's (ticker: TSLA) tripling this year was an epic squeeze of those comic-book villains who had doubted Musk and sold more than a third of free-trading Tesla shares short. That fuel seems spent, for the moment. Traders say that the recently unborrowable shares are available again and can be had for a single-digit interest rate, instead of last month's 90% vig. With the shorts in retreat, Tesla should trade more in line with its fundamentals.

TESLA'S MODEL S SEDAN has won every car award in sight, and test drives by several Barron's staffers convinced us the Model S deserves the accolades. ..

Contentions

[Obama's Diplomatic Humiliation](#)

by Max Boot

Forget “Where in the world is Carmen Sandiego?” The hottest real-time game in the world is: Where in the world is Edward Snowden? The rogue NSA techie—who, in the [judgment](#) of the NSA's head, Gen. Keith Alexander, “has caused irreversible and significant damage to our country and to our allies”—has fled Hong Kong and wound up in Moscow. He was rumored to be heading to Ecuador via Havana but he didn't make the Aeroflot flight he was expected to take, leaving a pack of journalists who bought tickets to photograph an empty seat. So

presumably Snowden remains in Russia at least for the time being, with rumors swirling that Ecuador or possibly Venezuela remain his destination of choice.

No matter what he's up to, he's making the United States government look foolish. Hong Kong's decision—which, in effect, means Beijing's decision—to let him leave even though he is wanted on felony charges in the United States and had his passport suspended suggests that notwithstanding the positive atmospherics from the recent summit meeting between President Obama and President Xi Jinping, there remain sharp limits on how far the Communist regime is willing to go to accommodate American concerns. Indeed, Beijing seems to be positively reveling in Snowden's unfortunate revelations about the NSA's penetration of Chinese computer networks, which serves to deflect attention from the much more massive intrusions into computer networks both foreign and domestic that Beijing routinely undertakes. Vladimir Putin, for his part, doesn't seem to have heard of any "reset" in relations with the U.S. He, too, appears happy to grant Snowden sanctuary, at least for a short while, as a way of giving Uncle Sam the middle finger.

Then we come to Ecuador, whose president, Rafael Correa, appears to be bidding for leadership of the anti-American bloc in Latin America—a position left open by Fidel Castro's enfeeblement and Hugo Chavez's death. He has already granted refuge in Ecuador's London embassy to WikiLeaks founder and accused rapist Julian Assange. Now he may very well try to grant sanctuary to Snowden too. He is entitled to do that, but Washington should make clear to him that if he does so he will suffer the consequences—including a loss of trade privileges that could threaten the \$10.7 billion worth of goods that nation [exports](#) to the U.S. every year.

This is all, it must be said, a colossal embarrassment for President Obama. He looks, to unsympathetic eyes at least, to be a budding tyrant (witness all of the absurd and overheated comparisons between the NSA's measured and carefully controlled activities and those of authoritarian states such as China and Iran which spy on their own people to suppress dissent)—and a notably ineffectual one at that who can't even snare one [Pepsi-swilling, pizza-gobbling](#) computer geek.

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Contentions

[Putin Is Cleaning Obama's Clock](#)

by Peter Wehner

Barack Obama's "reset" with Russia is really going well, don't you think?

Russia is defying America by granting Edward Snowden, who exposed some of the most classified secrets of our government, safe haven as he continues to elude capture. As Reuters [reports](#):

Washington was stung by Russian defiance... The White House said it expected the Russian government to send Snowden back to the United States and lodged 'strong objections' to Hong Kong and China for letting him go. U.S. Secretary of State John Kerry said during a visit to India that it would be "deeply troubling" if Moscow defied the United States over Snowden, and said the fugitive "places himself above the law, having betrayed his country". But the Russian government ignored the appeal and President Vladimir Putin's press secretary denied any knowledge of Snowden's movements. Asked if Snowden had spoken to the Russian authorities, [Dmitry] Peskov said: "Overall, we have no information about him."

This comes on top of Russia defying America's wishes in the Syrian civil war, with Russia once again reasserting its presence in the Middle East after having been essentially expelled from there in the 1970s (a product of Henry Kissinger's masterful diplomacy).

Russia was an early and strong supporter of the Assad regime, while America is a late and weak supporter of the rebel groups. President Obama wants Russia to help us; Putin wants Assad to win. And thanks in good measure to Russia, Assad (and hence Iran) is winning.

The Syrian debacle comes in the aftermath of Obama scrapping in 2009 a missile-defense system the Poles and the Czech Republic had agreed to house despite Russian threats, as a way to pacify Putin. ("The U.S. reversal is likely to please Russia, which had fiercely opposed the plans," CNN [reported](#) at the time.)

Add to that Putin's support for Iran's nuclear ambitions and his crackdown at home. (The *Washington Post* [writes](#) that in "an attempt to suppress swelling protests against his rigged reelection and the massively corrupt autocracy he presides over, Mr. Putin has launched what both Russian and Western human rights groups describe as the most intense and pervasive campaign of political repression since the downfall of the Soviet Union."). Taken all together, you can see that the Obama "reset"—which at the dawn of the Obama administration was [described](#) as a "win-win" strategy for both nations—has been a rout for the Russians.

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Power Line

[How Could a Goofy Techie Expose Our Government's Incompetence?](#)

by John Hinderaker

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Well, it certainly can domestically. Not only can it sic the IRS on its political opponents, it can buy whatever votes may be necessary with other people's money. Dealing with foreign countries, where such powers come up short, is another story.

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Actually, they botched much more than that. How in the world could the NSA allow a random employee of a contractor, Booz Allen, who had been on the "job" for only a couple of months, such unfettered and apparently uncharted access to secret materials? The fact that the NSA did so is the best argument against that agency's being a trustworthy custodian of Americans' secrets.

The latest wrinkle in the Snowden saga poses a different set of questions for an administration that has spent weeks fending off questions about whether it has abused its power to collect taxes, investigate criminal activity and fight terrorism.

Abusive **and** incompetent! That's Barack Obama.

On Monday, administration officials said they had done all they could to bring Snowden to justice. Chinese defiance, rather than bureaucratic bungling, had allowed the 30-year-old former contractor to slip out of Hong Kong as officials there weighed Washington's request for extradition, they said.

Well, yeah. The Chinese hold our mortgage, so why would they pay any attention to Barack Obama? Obama's policy of borrowing \$17 trillion isn't what a sane person would consider smart.

Snowden's exact whereabouts were a mystery on Monday as Russia resisted White House pressure to stop him during his journey to escape U.S. prosecution.

Of course they did. Reset! Vladimir Putin is a smart, tough guy. Barack Obama—I will be gentle here—isn't. [Pete Wehner](#) sums up their relationship:

Add to that Putin's support for Iran's nuclear ambitions and his crackdown at home. (The Washington Post writes that in "an attempt to suppress swelling protests against his rigged reelection and the massively corrupt autocracy he presides over, Mr. Putin has launched what both Russian and Western human rights groups describe as the most intense and pervasive campaign of political repression since the downfall of the Soviet Union."). Taken all together, you can see that the Obama "reset"—which at the dawn of the Obama administration was described as a "win-win" strategy for both nations—has been a rout for the Russians.

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Let's not lose sight of the fact that the "reset," and the disaster of American foreign policy over the last four years, have been attributable not only to Obama, but to our old-lady-president in waiting, Hillary Clinton.

Snowden's decision to go on the lam creates another headache for the Obama administration, which has seen priorities like immigration reform threatened by a string of scandals.

That, plus the fact that the immigration "reform" bill is a disaster.

When it comes to the NSA revelations, most lawmakers were already aware of the surveillance program and few have raised objections. Republicans by and large have focused their criticism on Snowden and China rather than the administration.

That may change if the ordeal drags on. Republican Representative Peter King of New York on Monday said Obama should have taken a harder line with the Chinese authorities who ultimately control the semi-autonomous region of Hong Kong.

"I hate to be in the middle of a crisis second guessing the president, but where is he? Where is the president? Why is he not speaking to the American people? Why is he not more forceful in dealing with foreign leaders?" King said on CNN television.

Those are rhetorical questions, obviously. Barack Obama has never been a real president. He has never led. He seems to view his job duties as an unfortunate distraction from golfing and partying with celebrities. How could anyone be surprised to learn that he is an inept, ineffective president?

There are also likely to be increasingly embarrassing questions about how Snowden managed to download and take many highly sensitive documents when he was working in Hawaii for NSA contractor Booz Allen Hamilton. The head of the NSA, General Keith Alexander, said on Sunday that he did not know why the NSA did not catch Snowden before he left Hawaii for Hong Kong in May.

Well, that's reassuring! The NSA has wonderful technical capabilities to spy on everyone in the world, but can't figure out how its own contract employee made off with a pocket full of secrets. Maybe that's a sign that the U.S. would be ill-advised to go down the road of totalitarian, all-knowing government. Maybe we can start by repealing Obamacare.

Obama first learned that Snowden had turned up in Hong Kong on Sunday, June 9, as he flew back from a weekend of talks with Chinese President Xi Jinping.

But Obama does not appear to have played a direct role in trying to get him back.

Really? There's a shock! Obama hasn't played a "direct role" in anything other than an election campaign since he first ran for the Illinois State Senate.

Obama declined to say on Monday whether he has spoken directly with Russian President Vladimir Putin or other foreign leaders about the extradition efforts. Obama had an icy meeting with Putin a week ago at the G8 summit in Northern Ireland.

Reset! Reset! Remember how contemptuous the wet-behind-the-ears Barack Obama and his newly-minted Secretary of State Hillary Clinton, whose only claim to fame was her marriage to Bill, were of the Bush administration's Russia policy? Reset! Putin thinks Obama is an idiot. Can you blame him?

Obama's public schedule leaves little room for the extradition effort. He makes a major speech on climate change on Tuesday, and then leaves on a week-long trip to Africa.

This is really pretty funny. Obama would surely deal with the crisis that was brought about by his administration's incompetence, only he is too busy! He's going to prevent climate change—sure he is! Just dial down that CO2 thermostat! Well, our small part of it, anyway. And no doubt his trip to Africa will be just as productive as the hundred or so trips to Africa by his predecessors have been. Too busy to actually function as president? That's our Barack! With luck, he will be able to squeeze in a couple of rounds of golf.

Though the White House has distanced itself from the Snowden affair...

Of course! The White House distances itself from everything. If you have ever wondered what it would be like to live in a U.S. that didn't have a president—vis-a-vis foreign countries, at least—you are now finding out.

Officials from the FBI, the Justice Department and the State Department worked with their counterparts in Hong Kong to extradite Snowden over the next several days, culminating in a telephone call between U.S. Attorney General Eric Holder and Hong Kong's Secretary for Justice, Rimsky Yuen, on June 19.

"There was a sense that the process was moving forward," a Justice Department official said, speaking on condition of anonymity.

Hong Kong officials asked for more information and evidence two days later, but did not give the United States enough time to respond before Snowden left the Chinese territory on June 23.

We should have known that Eric Holder would be involved in the fiasco, somehow. One can only imagine what the Chinese think of Holder.

George Terwilliger, who served as the Justice Department's No. 2 official under President George H.W. Bush, said it was too early to know whether the agency should be blamed for failing to get Snowden.

"These are not legal issues, per se. They're political and diplomatic issues, and most of the skills that are exercised are exercised away from the public eye."

Or not exercised, as the case may be. When you read these stories in which European journalists make fun of the Obama administration, you need to keep in mind that most of them, along with the European elites whom they represent, *want* the United States to be weak. That is why they awarded Obama a Nobel prize before he had done anything at all: it was a Nobel prize for weakness. But even the Euros can't resist laughing at what a fool we have for a president. A fool, anyway, if you assume that we all want the United States to be a strong and prosperous nation.

Right Turn

[Second-rate power: The Obama legacy](#)

by Jennifer Rubin

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To paraphrase [Robert Kagan](#) and [Charles Krauthammer](#), decline is a choice and we have chosen it. It is remarkable that the president thought he could continue to remain relevant on the world stage after he "ended" (i.e. abandoned) wars, slashed defense, allowed Iran to run the negotiation schedule, kowtowed to the Chinese and cut the legs out from every ally from Poland and the Czech Republic (which lost anti-missile sites) to Israel (condemning its building and making Palestinian demands on bargaining the official policy of the United States).

As [Kim Holmes](#) puts it, "Overall, the defining characteristic of Obama's foreign policy appears to be preventing overseas crises from distracting from his domestic agenda. He remains a committed liberal, at least in principle, but his foreign policy is highly influenced by political expediency, which causes him to want to avoid risking overseas interventions." it is not so much "leading from behind" as it is hiding under the bed.

There are two schools of thought on Obama's approach.

One is that this is all a self-fulfilling prophecy. He wanted to let multilateral institutions decide matters of huge consequence. He wanted to prevent the United States from engaging in further war-making. He didn't want to confront autocratic regimes. He felt the United States was not entitled to instruct other countries on human rights. And look how much he has "accomplished." Retrenchment breeds inactivity which in turn becomes irreversible paralysis.

The other school of thought is that he never understood how geopolitics works. He imagined that he could persuade our foes of the errors of their ways. He believed (and still does) that if we disarm, others will follow our lead (although this has never happened). He thought the problem between the United States and Iran, the United States and Russia, and the United States and China was "mistrust" or failure to atone for our past sins. And, most of all, he believed his own hype that he was a transformational figure whose mere presence would bend events and remake the relationship between powers.

Whether by intention or incompetence, he now finds that exercising simple functions of sovereignty (getting a traitor back) or enforcing basic international norms (no WMD's, please) becomes exceedingly difficult. Shedding the instruments and habits of a superpower (maintain hard power, back up our words with action, be a reliable ally) does not leave us safer and more secure. To the contrary, we are at the mercy of events and relegated to pleading with unfriendly regimes.

The Obama era is a good lesson for the isolationist left and right which imagines we can and should get by with a smaller military, fewer bases and troops overseas, less involvement in others' affairs and that old saw horse — cutting foreign aid. The slogan for this is in effect: "Like Obama, but more so!"

That is a frightening prospect, as is another 3 1/2 years of the Obama presidency. More so than at any time in recent history (certainly going to WWII) we are not masters of our own fate nor guarantors of the West's security. We are on our way to becoming a second-rate power in an increasingly dangerous world.

Barron's **Recharge Now!**

Tesla's electric car offers a quiet, powerful ride. But unless it comes up with a cheaper, stronger battery, the stock could turn out to be a lemon.

by Bill Alpert

Google "Iron Man, Tony Stark" and within the first few results you'll find Websites likening that superhero to Elon Musk, 41, the entrepreneur behind PayPal, the rocket maker SpaceX, and the electric-car sensation [Tesla Motors](#). The comparison's apt. Musk is smart and stylish, and he fights planetary threats like global warming by creating spacecraft and zero-emissions cars that shame NASA and the auto giants. He's as rich as Iron Man's armored billionaire, too. Tesla shares rocketed this year from \$35 to \$115 -- lifting the Palo Alto auto start-up to a market value of \$14 billion at May's end -- before easing back to a recent \$102, where Musk's quarter-interest in the company is still worth \$3.4 billion.



Barron's takes the car, and the stock, for a test drive. One comes out a winner.

It's possible to admire Musk's achievements, while still wondering if Tesla's stock market fans are viewing its prospects through 3D glasses. The towering expectations now priced into the stock don't account for the Grand Canyon leap that Tesla must make to reach its goal of cutting its car's \$90,000-plus sticker price in half. Electric-car batteries cost a heck of a lot, and today's

Tesla Model S owes its better-than-200-mile range to batteries costing tens of thousands of dollars. Industries and governments around the world have spent billions on battery research, but few expect to trim electric-car battery costs by more than 20%-30% by the planned 2016 launch of Tesla's car for the Everyman. Perhaps Musk will confound the industry again, but if Tesla's next-generation car can't go the distance at half the price, its stock will head much lower.

One ingredient that fueled Tesla's (ticker: TSLA) tripling this year was an epic squeeze of those comic-book villains who had doubted Musk and sold more than a third of free-trading Tesla shares short. That fuel seems spent, for the moment. Traders say that the recently unborrowable shares are available again and can be had for a single-digit interest rate, instead of last month's 90% vig. With the shorts in retreat, Tesla should trade more in line with its fundamentals.

TESLA'S MODEL S SEDAN has won every car award in sight, and test drives by several *Barron's* staffers convinced us the Model S deserves the accolades. It has attracted 10,000 buyers in less than a year, and Musk told shareholders at last Tuesday's annual meeting that North American sales for the electric luxury car look as if they'll be 15,000 units this year.

But it will take time to discover how much sustained demand there is for a marvel priced above \$90,000 (the price for a Model S Performance version, after a \$7,500 federal tax credit). No one yet knows what portion of Tesla's initial buyers were "early adopters," unrepresentative of ongoing demand. Tesla irked analysts last month when it stopped disclosing its end-of-quarter order backlog -- which might have shed light on the issue -- after previously trumpeting a 15,000-unit reservation list.

The Model S won't get Tesla profits to a level that justifies today's stock price. The company expects to sell 21,000 worldwide this year, and Musk told shareholders on Tuesday that the car's annual sales might eventually reach 30,000 or 40,000. At about the 30,000 units that most bullish analysts predict for 2014, Tesla might earn about a buck a share (if you don't count the expense of stock options) -- which means the \$102 stock is flying at 100 times next year's earnings forecast.

A top-of-the-line SUV called the Model X will bolster sales volume in 2015, but today's stock price is really a bet that Tesla can sell hundreds of thousands of cars a year, starting with the late 2016 launch of the Gen III that's supposed to cost well under \$50,000. But there will have to be breakthroughs in battery technology to get Tesla to that price level without skimping on range; the Model S can go more than 200 miles on a charge. A battery-starved Gen III would encounter the same disappointing demand as other affordable electrics, like the [Nissan](#) Leaf (7201.Japan), [Ford](#) Focus EV (F), or [General Motors'](#) (GM) plug-in hybrid Chevy Volt.

Stubbornly costly batteries may even cause headaches when today's Tesla's luxury cars arrive on the used-car lot. Folks who buy \$90,000 cars tend to replace them every few years, and the bid for a four-year-old Model S may prove disappointing if it's going to need an expensive new battery in a few more years. Musk has astutely met that concern with a financing option guaranteeing resale value, but that just shifts the risk to shareholders.

As a result, Tesla's balance sheet will sprout a contingent liability for the "residual value" of those cars, and analysts worry that the amount will quickly rise to hundreds of millions of dollars -- on the order of half of the company's book value. The deferred impact of all those used

batteries will become clearer in coming years, after Tesla also starts running low on the government-legislated zero-emission-vehicle credits that offset \$68 million in expenses in the March 2013 quarter.

Now for the tricky part of Tesla's road test

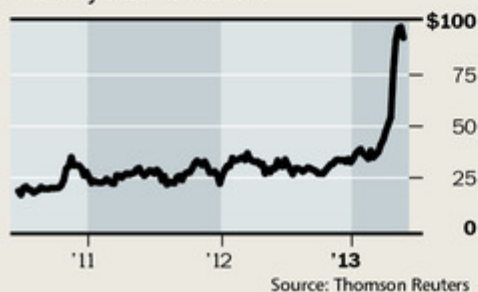


Designing, making, and selling the battery-powered Model S, which has won rave reviews, is a major accomplishment that has quieted many skeptics...

...And sent Tesla's stock vertical...

Tesla Motors (TSLA - Nasdaq)

Monthly close on June 6



...Yet the Model S is selling into a limited market for luxury-class models.

North American Sales

Make/Model	Base Price	Unit Sales
Audi A6	<\$75,000	19,000
BMW 7 Series	>90,000	12,000
Lexus LS	>72,000	11,000
Mercedes-Benz S-Class	>92,000	13,000
Tesla Model S*	>90,000	15,000

*Performance version, after \$7,500 tax credit Sources: Companies, Barron's

We had hoped Musk would advise us on these points, but our scheduled interview with him ended abruptly on Friday, when he hung up on us.

"I have no interest in an article that debates what we consider to be an obvious point -- which is that there is a dramatic reduction in battery costs," Musk said, after a few questions. "You clearly do not understand the business. My apologies. I am terminating the interview."

ELON MUSK IS NOT A GUY you like to bet against. He co-founded the Internet payment business PayPal, which eBay bought for \$1.5 billion in 2002, after he had launched Space

Exploration Technologies, the private company whose rockets began resupplying the International Space Station after NASA's own shuttles became museum pieces. Since 2008, Musk has been CEO of both SpaceX and Tesla, while chairing the board of the solar-power outfit [SolarCity](#) (SCTY).

Morgan Stanley auto analyst Adam Jonas compared Musk to railroad pioneer Cornelius Vanderbilt and Thomas Edison, in a report last month that called Tesla the best American auto maker and the analyst's top pick.

Tesla's first electric car was the \$110,000 Roadster, a two-seater whose limited production couldn't buoy it through the 2008 financial crisis. Tesla survived with a \$465 million loan from the U.S. Department of Energy, investments by [Daimler](#) (DAI.Germany) and [Toyota](#) (7203.Japan) -- which buy electric powertrains from Tesla -- and a 2010 initial offering of shares at \$17 apiece. It helped that Tesla was unencumbered by union contracts or pensions. By June 2012, the Model S started rolling off the robotic assembly lines of a Fremont, Calif., plant that Tesla had bought for a song from GM and Toyota.

The Model S is a sensation. Motor Trend anointed it the 2013 Car of the Year, while the curmudgeons at Consumer Reports rated it 99 out of 100. Its electric motor has one moving part -- a simple design that has powered everything from blenders to locomotives since the 1888 patent on an alternating-current motor was issued to the company's namesake, inventor Nikola Tesla. The high price of the Model S lets it pack enough battery capacity to overcome the range limitations that stifle sales of cheaper electric cars.

In a test drive around Manhattan last month, the Model S lived up to its hype. Acceleration was smooth and quiet. The 17-inch touchscreen served up Slacker Radio stations, Google Maps, and anything else on the Internet. Passersby stopped for a look.

Tesla shares began their melt-up last month, when the company said it had sold 4,900 cars in the March quarter, generating \$560 million in revenue and its first profit: \$15 million, or 12 cents a share. Close examination revealed that the profit followed \$68 million in payments from other car makers that haven't met federal quotas for producing zero-emission cars. They can purchase clean-air credits from auto producers like Tesla. Still, Tesla's March sales put the Model S on track for annual sales of 20,000 cars--topping the North American volume of successful luxury sports sedans such as the Audi A6 or the BMW 7 Series (see table). And sales hadn't even begun in Europe or Asia.

Elon's Next Challenge

To address these limitations, Tesla founder and CEO Elon Musk predicts that the third-generation Tesla, to be called Gen III, will open the mass market for its electric automobiles in 2016. Even so, there could be some serious bumps in the road ahead for both the existing and coming models.

- The \$90,000 Model S is simply too pricey to achieve high-volume sales. The battery alone, which provides a range of 230 miles, costs tens of thousands of dollars.
- The more affordable Gen III, available in three years, will have a less expensive battery, but at the cost of a shorter per-charge range.

- Tesla is an affluent suburbanite's car. The Supercharger infrastructure of nationwide charging stations, announced last week with much fanfare, won't address the hassles faced by city dwellers, especially in Europe.
- The zero-emissions credits that subsidized Tesla's recent expenses will go away next year.
- At \$102 a share, Tesla will need to sell hundreds of thousands of cars per year to support its stock price. That's unlikely for the range limited Gen III; and the Model S would have to match the worldwide sales of BMW's best-selling car

The stock leapt 50% after the March-quarter results, and the company took the occasion to raise \$1 billion on May 24, through a \$660 million convertible-note offering, plus the sale of stock at \$92 a share, including \$100 million subscribed to by Musk. With fanfare, Tesla repaid the remainder of its \$450 million government loan and said that it would spend some of its new capital to expand its network of Superchargers—specially equipped locations that can recharge a Model S in a half-hour, instead of the usual overnight span. The network will grow to 100 stations by next year. Musk said he will demonstrate its reach this coming winter by making a cross-country road trip with his kids, "like the Chevy Chase movies."

So much good news for Tesla sent short sellers running for cover, squeezing the stock up to \$115 on May 29. "We had to cover," one bear told *Barron's*. "The position tripled on us in as many months." Longs who had taken margin loans to buy Tesla shares, won big, and none bigger than Musk. Filings show that he raised his equity stake to 28% from 27% with the help of \$150 million in loans from Goldman Sachs.

When Tesla investors return their attention to fundamentals, they should think about the company's make-or-break plan to reach high sales volume in 2017 with the Gen III. Morgan Stanley's Jonas notes that the Gen III accounts for 75% of his long-term volume forecasts and two-thirds of his \$109 share-price valuation. That forecast anticipates sales surpassing 450,000 units a year by 2027, at higher profit margins and valuation multiples than the rest of the auto industry.

The challenge is battery cost. The Morgan Stanley analyst assumes that it can drop by half, from \$400 to \$200 per kilowatt hour, and that consumers will accept a driving range below 140 miles. But the U.S. government and industry researchers say the cost performance of batteries is coming down slower than hoped. At GM, Director of Global Battery Systems Bill Wallace believes that battery-capacity costs can improve by about 20% in the next few years, with longer odds of saving 40% if new technologies pan out in five years.

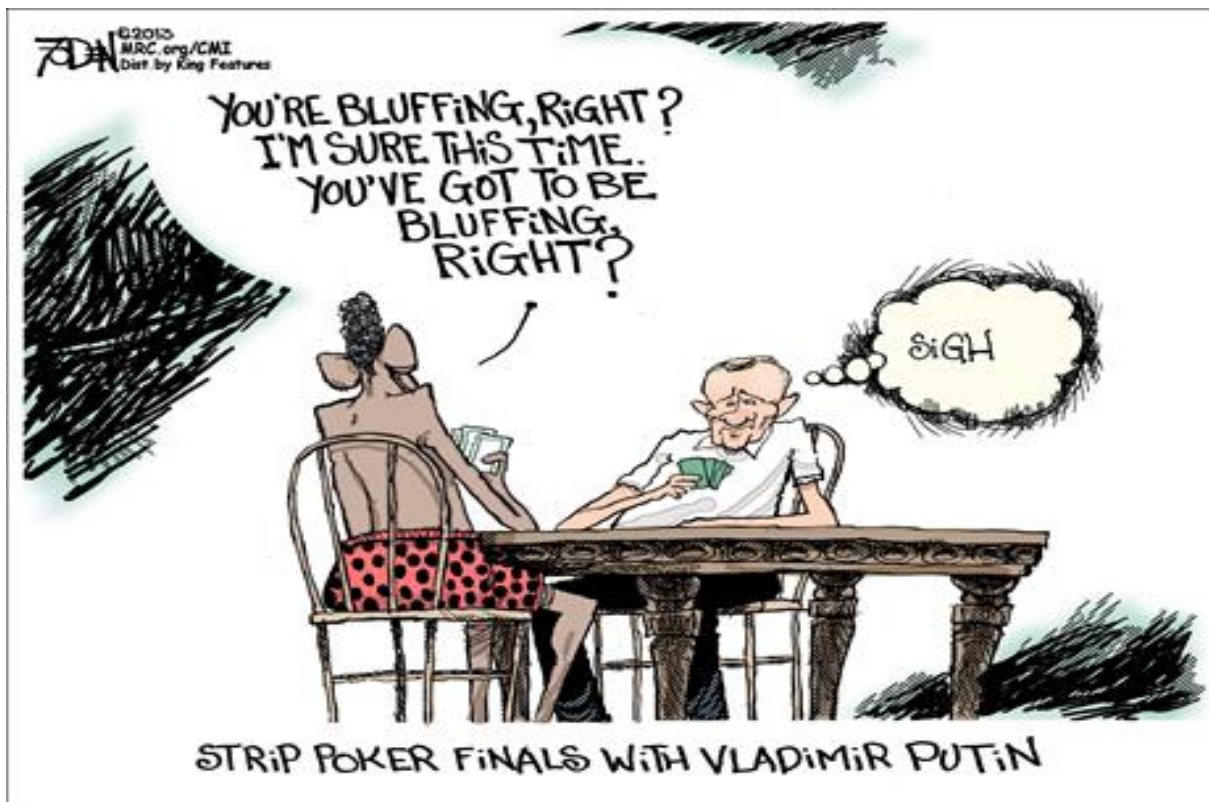
Before ending our interview, Musk said that improvements will cut the cost of the Model S's battery to \$10,000-\$12,000.

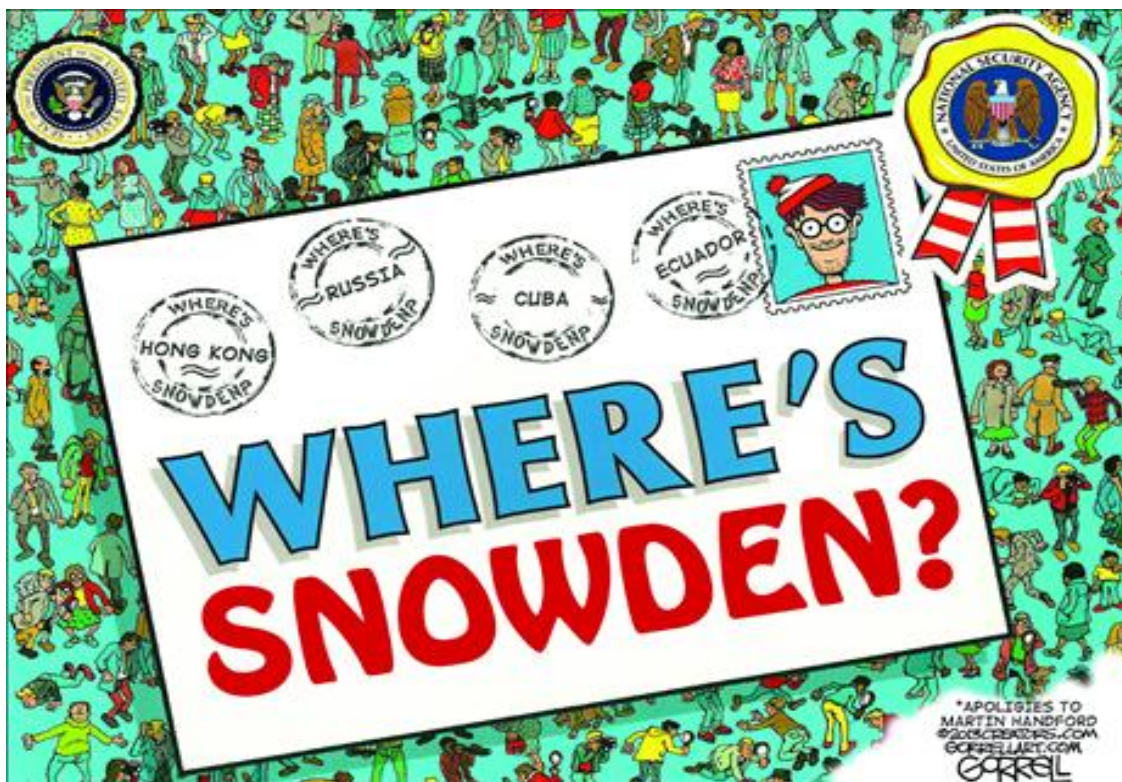
Musk will succeed at establishing Tesla as a valuable brand, even if it winds up confined to the luxury bracket of the Model S and its crossover cousin, the Model X. Tesla stock, therefore, has a floor at whatever price a giant like Daimler might pay to buy the company. But an acquirer wouldn't wildly overpay for the cash flow expected from those luxury lines. Morgan Stanley sees Tesla's free cash flow hitting \$400 million in 2016 -- the year before Gen III's expected launch. A Harley-Davidson multiple on that cash flow -- 10 times -- would support a Tesla stock price in

the \$30s. A BMW multiple of three times would point to a \$10 price. Those levels surely undervalue Tesla and Musk. We suspect there'd be plenty of buyers at \$50.

The mass-market segment will be crowded by the time Tesla plans to deliver Gen III. Chevy just introduced GM's first all-electric car, the Spark EV, at \$20,000 (after the \$7,500 tax credit). Consumers seem cool to paying more for an electric vehicle with a driving range that's a fraction of an internal-combustion model's. Disappointing demand drove price cuts last month on Honda's Fit EV and Nissan's Leaf. The category-leading Leaf sold fewer than 10,000 units last year.

We're sure Musk could have told us why potential buyers of affordable electrics still see internal-combustion-powered cars as a cheaper, more convenient choice.





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