

Carvana (CVNA) Is Enron 2: Buy OTM LEAP Puts in 2021

Summary

- Carvana is a used car loan originator that retail traders believe is a "disruptive" auto retailer ("The Amazon of Used Cars").
- Carvana has been unprofitable since its inception in the early 2010s, yet its "growth story" (pumped regularly in the financial media) has allowed the company to siphon billions from investors.
- As the price of CVNA has rocketed toward \$400/share, insiders have sold more than \$4 billion in stock.
- Since the pandemic, Carvana's CEO, Ernest Garcia III, has been making frequent appearances in the financial media while his father, Ernest Garcia II (Carvana "co-founder" and former Charles Keating associate), has been selling tens of thousands of shares PER DAY.
- When interest rates rise, the party ends; they won't be able to service their debt. Carvana will meet Enron's fate when rates rise above 3%.



We're going to "speculative stock party" like it's 1999!

Like Homer Simpson getting smashed at his own house party, investors have been going on a speculative stock binge during this "FPPSP" (Fed-Promoted Pandemic Stock Party™). Some notable examples:

- [Nikola](#), a 7 year-old electric vehicle “startup”, has never produced a vehicle. Yet in June 2020, *it was worth more than the Ford*.
- [Gamestop](#), a nearly-40 year-old brick-and-mortar (wow, that’s a lot of hyphens) retailer with an unprofitable and secularly-challenged business model, *had a 52-week high stock price of \$450+*.
- [Peloton](#), a stationary bicycle manufacturer and pandemic novelty that Wall Street considers a “technology company”, *was worth nearly \$50 billion earlier this year*.



Amid this Fed-fueled insanity, there’s Carvana (CVNA), a *decade-old ecommerce platform* for buying and selling used cars that’s climbed to a *\$50+ billion valuation despite having never earned a profit*.

But CVNA isn’t just another insanely speculative stock...it’s a “total fraud”, like Frank Grimes called Homer (accurately).



Bet the jockey, not the horse.

Ernest Garcia II, the “co-founder” of Carvana (CVNA is an **extension of his privately-owned DriveTime**), is a used car salesman, subprime lender, stock promoter, and “smartest guy in the room”.

Imagine *The Simpson’s* attorney Lionel Hutz as EGII and Carvana’s “commemorative coins” and “used car vending machines” as the gimmicks Mr. Hutz used to attract clients to his struggling law firm.



Hiring me as your attorney, you'll also receive this free smoking monkey. -Attorney Lionel Hutz

Similar to the non sequitur warning Mr. Hutz gave during his initial consultation (“you better slow down there, smokey”), Carvana, which really does give its customers an **oversized commemorative coin** with which to retrieve their cars from CVNA’s “vending machines” (like so many smoking monkeys), warns investors of *fake news risk factors* in its 10k:

Negative research about our business published by analysts or journalists could cause our stock price to decline. A lack of regularly published research about our business could cause trading volume or our stock price to decline.

The trading market for our Class A common stock depends in part on the research and reports that analysts and journalists publish about us or our business. If analysts or journalists publish inaccurate or unfavorable research about our business, our stock price would likely decline. If we fail to meet the expectations of analysts for our operating results, or if the analysts who covers us downgrade our stock, our stock price would likely decline. If one or more of these analysts ceases coverage of us or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price and trading volume to decline.

Short sellers of our stock may be manipulative and may drive down the market price of our common stock.

Short selling is the practice of selling securities that the seller does not own but rather has borrowed or intends to borrow from a third party with the intention of buying identical securities at a later date to return to the lender. A short seller hopes to profit from a decline in the value of the securities, as the short seller expects to pay less in the covering purchase than it received in the sale. It is therefore in the short seller’s interest for the price of the stock to decline, and some short sellers publish, or arrange for the publication of, opinions or characterizations regarding the relevant issuer, often involving deliberate misrepresentations of the issuer’s business prospects and similar matters calculated to create negative market momentum.

As a public entity in a highly digital world, we have been and in the future may be the subject of concerted efforts by profiteering short sellers to spread misinformation and misrepresentations in order to gain an illegal market advantage. In the past, the publication of intentional misinformation concerning Carvana by a disclosed short seller could be associated with the selling of shares of our common stock in the market on a large scale, resulting in a precipitous decline in the market price per share of our common stock. In addition, the publication of intentional misinformation may also result in lawsuits, the uncertainty and expense of which could adversely impact our business, financial condition, and reputation.

While utilizing all available tools to defend ourselves and our assets against these short seller efforts, there is limited regulatory control, making such efforts an ongoing concern for any public company. While we move forward in our business development strategies in good faith, there are no assurances that we will not face more of these short sellers’ efforts or similar tactics by bad actors in the future, and the market price of our common stock may decline as a result of their actions or the action of other short sellers.

Here's a photo of the former Charles Keating associate at the Carvana IPO (with a useful background link): [How An Ex-Con Became A Billionaire From Used Cars](#)



Amazon had cashflow from day one; Carvana had Ernest Garcia II's fingerprints all over it from day one.

Carvana has done a great job pitching itself as the "Amazon of Used Cars"...it is true that it has a website, and it's also true that its cars can be purchased and financed online. However, there are..."some" notable differences between CVNA and AMZN.

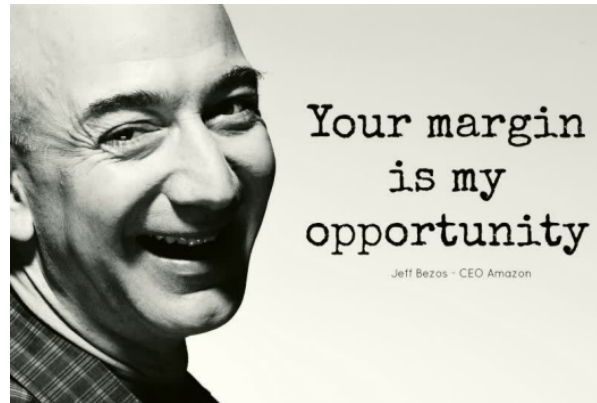
The key to the Amazon business model "**From Day One**" (and for the subsequent >20-years) has been *cash flow*. Bezos has always presented the cash flow statement first in Amazon financials...he's a smart guy; cash is king.

Amazon sold books over the internet and received cash *before* they paid suppliers or customers. As seen in the below 10k from 2004 (when Amazon was generating similar revenues as Carvana), Bezos' baby wasn't just a *profitable* company (i.e. it generated *net income*)...it also had robust cash flow:

AMAZON.COM, INC. CONSOLIDATED STATEMENTS OF CASH FLOWS (in thousands)			
	Year Ended December 31,		
	2004	2003	2002
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	\$ 1,102,273	\$ 738,254	\$ 540,282
OPERATING ACTIVITIES:			
Net income (loss)	588,451	35,282	(149,132)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation of fixed assets, including internal-use software and website development, and other amortization	75,724	75,558	82,274
Stock-based compensation	57,702	87,751	68,927
Other operating expense (income)	(7,964)	2,752	8,948
Gains on sales of marketable securities, net	(586)	(9,598)	(5,700)
Reversals and other	824	130,097	100,442
Non-cash interest expense and other	4,756	12,918	29,586
Deferred income taxes	(256,696)	931	(553)
Cumulative effect of change in account principle	—	—	(801)
Changes in operating assets and liabilities:			
Inventories	(168,896)	(76,786)	(51,303)
Accounts receivable, net and other current assets	(1,745)	1,616	(31,704)
Accounts payable	286,091	167,732	156,542
Accrued expenses and other current liabilities	(15,110)	(27,982)	3,800
Additions to unearned revenue	109,936	101,641	95,404
Amortization of previously unearned revenue	(106,886)	(111,740)	(135,466)
Interest payable	959	1,850	3,027
Net cash provided by operating activities	566,560	392,022	174,291
INVESTING ACTIVITIES:			
Sales and maturities of marketable securities and other investments	1,426,786	813,184	553,289
Purchases of marketable securities	(1,584,089)	(535,642)	(635,810)
Purchases of fixed assets, including internal-use software and website development	(89,133)	(45,963)	(39,163)
Proceeds from sale of subsidiary	—	5,072	—
Acquisition, net of cash acquired	(71,195)	—	—
Net cash (used in) provided by investing activities	(317,631)	236,651	(121,684)
FINANCING ACTIVITIES:			
Proceeds from exercises of stock options	60,109	163,322	121,689
Repayments of long-term debt, capital lease obligations	(157,401)	(495,308)	(14,795)
Net cash (used in) provided by financing activities	(97,292)	(331,986)	106,894
Foreign-currency effect on cash and cash equivalents	48,690	67,332	38,471
Net increase in cash and cash equivalents	200,327	364,019	197,972
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 1,302,600	\$ 1,102,273	\$ 738,254
SUPPLEMENTAL CASH FLOW INFORMATION:			
Fixed assets acquired under capital leases and other financing arrangements	\$ 860	\$ 2,677	\$ 3,023
Cash paid for interest	107,604	119,947	111,589
Cash paid for income taxes	4,051	1,825	1,448

Amazon grew aggressively because it could. Bezos didn't care about appeasing Wall

Street because he had a business model that self-financed as it grew. By combining the awesome power of its business model with the long tail of the internet, Amazon turned every retailer's margin into Bezos' opportunity.



Conversely, Carvana has operating cash flows that are *worse than losses*: Not only is CVNA not benefiting from working capital as it grows...it's spending more and more on vehicle inventory and receivables (used car loans).

After subtracting "growth" capital expenditures, including payments to insiders and related-parties, ***Carvana has burned approx. \$2 billion in the past 2 years.***

The second major difference of the Carvana cash flow statement is "originations of finance receivables", which in the past two years has been ***>75% of net used car sales.*** Amazon didn't provide financing for their customers...their customers loved the service so much that they just wanted to buy things from them.

Carvana *provides financing for more than 3/4 of the cars they sell*. Typically, retailers (auto and otherwise) **try to avoid offering financing** whenever possible.

Which leads to the third difference of the Carvana cash flow statement: "gain on loan sales", which in the past two years *has equaled nearly 30% of reported gross profit*.

The fact that "gain on loan sales" is reported as a separate line item (with no table anywhere in the notes to the financial statements) suggests that these gains are:

1) *Non-cash.*

OR

2) *Immaterial to earnings and cash flow.*



Who's buying these used car loans from Carvana, and why are they paying a premium?

That's the \$50 billion question. In fact, **it's been suggested** that selling loans *at inflated prices to related-parties* started the "rumor" of future profitability.

Currently, we know from Carvana's disclosures that Ally Bank and Ally Financial are its largest financing partners, pursuant to a "Master Purchase & Sale Agreement" (MPSA).

It's worth noting that Carvana does not disclose:

- 1) *The breakdown of "gain on loan sales".*
- 2) *Who's paying the premiums.*
- 3) *The assumptions underlying the gains.*

OR

4) *Any contingent liabilities, repurchases, or make-whole provisions that could have a negative effect on CVNA's net income.*

They've also used the hot Asset-Backed Security "ABS" market in recent years with several securitization trusts in the \$400 million range *consisting of deep-subprime used car loans*. (Queue the **"Jenga scene" from *The Big Short***.)

We may know the right questions to ask...but getting the right answers and being able to independently verify them is likely a bridge too far. So, what are the possibilities?

1) *The gains are non-cash and should be totally excluded from any profitability analysis.*

2) *The gains should be handled cautiously, as they're transient (i.e. they're a function of the current market environment).*

OR

3) *The gains are awesome and will continue indefinitely!*

For the record, Carvana advises against Option 3:

We depend on the sale of automotive finance receivables for a substantial portion of our gross profit.

In connection with the sale of used vehicles, many of our customers use our financing services to finance a portion of the purchase price of their vehicle. The prices we are able to charge for finance receivables that we sell are based on a variety of factors, including the terms and credit risk associated with the automotive finance receivables, the relationship between the interest rates we quoted the customer at the time they priced their financing and market and projected interest rates at the time we sell the finance receivables, the historical credit performance of the finance receivables we sell, the financing partner and securitization purchaser demand and other factors. If these variables or others were to change, we might be required to reduce our sale prices on finance receivables, sell fewer of them, or both, which could reduce our gains on sales of finance receivables. Any material reduction in our interest rate spread or gains on sale of finance receivables could have a material adverse effect on our business, results, of operations, and financial condition. Furthermore, customers may elect to finance their vehicle purchases through other parties who may be able to offer more attractive terms, in which case we would lose a source of what has historically been a significant portion of our gross profit.

Whatever the case may be, *it's clear that Carvana is much more reliant on the financial and credit lending markets than a pure retailer.*

An “Amazon of used cars” it is not.

In fact, Carvana is more Affirm than Amazon.

Given that the biggest contributor to Carvana's gross profit is not selling used cars but *selling used car loans*, it makes sense to think of it as a lender. Let's compare it to an emerging tech-focused lender: **Affirm**.

Affirm is one of those "Buy Now, Pay Later" (BNPL) lending firms. When you browse for a Peloton and notice a monthly payment option with "0% APR", that's courtesy of Affirm. (28% of 2020 revenues were derived from Peloton.)

Carvana's cash flow statement might not look like Amazon's, but it looks remarkably similar to Affirm's:

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended June 30,	
	2019	2020
Cash Flows from Operating Activities		
Net Loss	\$ (120,455)	\$ (112,598)
Adjustments to reconcile net loss to net cash used in operating activities:		
Provision for credit losses	78,025	105,067
Amortization of premiums and discounts on loans	(19,375)	(27,605)
(Gain) loss on sales of loans	440	(31,907)
Changes in fair value of servicing assets and liabilities	(940)	(987)
Changes in fair value of convertible debt derivative	—	3,834
Amortization of debt issuance costs	1,698	2,313
Stock-based compensation	33,701	29,625
Depreciation and amortization	5,266	9,444
Deferred tax expense	36	385
Other	—	(304)
Purchases of loans held for sale	(858,661)	(2,101,483)
Proceeds from the sale of loans held for sale	813,309	2,021,938
Change in operating assets and liabilities:		
Accounts receivable, net	(24,791)	(19,049)
Other assets	(17,105)	19,936
Accrued interest payable	675	428
Accounts payable	4,435	7,514
Accrued expenses and other liabilities	9,782	13,868
Payable to third-party loan owners	6,311	8,279
Net Cash Used in Operating Activities	(87,649)	(71,302)
Cash Flows from Investing Activities		
Purchases of loans	(1,892,508)	(2,830,320)
Proceeds from the sale of loans	147,103	303,433
Principal repayments of loans	1,412,927	2,294,833
Additions to property, equipment and software	(19,406)	(21,019)
Purchases of intangible assets	(1,844)	—
Net Cash Used in Investing Activities	(353,728)	(253,073)
Cash Flows from Financing Activities		
Proceeds from funding debt	1,354,550	2,132,805
Payments of debt issuance costs	(4,850)	(7,687)
Principal repayments of funding debt	(1,080,481)	(1,882,155)
Proceeds from issuance of convertible debt	—	75,000
Proceeds from issuance of redeemable convertible preferred stock, net	303,083	15,481
Repurchases of redeemable convertible preferred stock	(14,498)	(22,591)
Proceeds from issuance of common stock	6,475	2,733
Repurchases of common stock	(2,631)	(18,854)
Net Cash Provided by Financing Activities	561,648	294,732
Net Increase (Decrease) in Cash, Cash Equivalents and Restricted Cash	120,271	(29,643)
Cash, cash equivalents and restricted cash, beginning of year	237,500	357,771
Cash, Cash Equivalents and Restricted Cash, End of Year	\$ 357,771	\$ 328,128

Even the description of their business model sounds similar...Affirm relies primarily on Cross River Bank, and Carvana relies primarily on Ally:

Our loan origination and servicing model

When a consumer applies for a loan through our platform, the loan is underwritten using our proprietary risk model. Once approved and the consumer selects their preferred repayment option, the substantial majority of loans are funded and issued by Cross River Bank, one of our originating bank partners.

We are also able to originate loans directly under our lending, servicing, and brokering licenses in Canada and across various states in the U.S. Under the self-origination model, we are able to improve our transaction economics.

We act as the servicer on all loans that we originate directly or purchase from our originating bank partners and earn a servicing fee on loans we sell to our funding sources. We also do not sell the servicing rights on any of the loans, allowing us to control the consumer experience end-to-end. To allow for flexible staffing to support overflow and seasonal traffic, we also partner with several sub-servicers to manage customer care, first priority collections, and third-party collections in accordance with our policies and procedures.

Efficient capital funding capabilities

Given our ability to automate our and our originating bank partners' underwriting processes at checkout and generate high-quality assets at scale, we have successfully attracted a diverse set of funding sources, which has allowed us to scale accordingly as we have increased the transaction volume on our platform. As of September 30, 2020, we had over \$4.2 billion in funding capacity from a diverse set of capital partners, and we have funded approximately \$10.7 billion of purchases since July 1, 2016.

By linking our pay-over-time product to a specific consumer, purchase, and merchant, we can target shorter-duration assets. Today our repayment options range from six weeks to 48 months, with an average duration of six months for assets retained on our balance sheet. This high-velocity of repayments creates a multiplier effect on our committed capital, where funding can be recycled quickly, driving our ability to increase transaction volume.

Affirm is the servicer on all loans they originate or purchase. This activity generates incremental fees, which are typically lucrative. In the case of Carvana, *related-party DriveTime (which **Ernie Garcia II owns**) is the major beneficiary of most loan servicing & administration agreements.*



Carvana as the dominant auto loan originator and the dominant online used car retailer? No.

The used car market is enormous and fragmented, with a \$1 trillion total addressable market (TAM) across various products and services. Many well-heeled, aligned, and operationally-healthy companies are competing for it, including:

Lithia: >30% CAGR (trades at 7.5x future EPS) - [Investor Presentation](#)

Asbury: >20% CAGR (trades at 6.5 future EPS) - [Investor Presentation](#)

CarMax: >10% CAGR (trades at >10x future EPS) - [Investor Presentation](#)

There's so much opportunity (and capital), that even unprofitable but well-financed digitally-native used car retailers have entered the fray:

Vroom - [Investor Presentation](#)

Carlotz - [Investor Presentation](#)




Shift - [Investor Presentation](#)

It's possible that one of these contenders *will* be the "Amazon of Used Cars" (implying near-total segment domination). However, if one company were to become dominant, it would likely be one of three at the top of the list, which:

1) *Have highly-economic business models that generate net income.*

2) *Do not rely on the capital markets to fund their operations.*

3) *Have highly-profitable alternate business lines (new cars and parts & services).*

	 LITHIA driveway NYSE:LAO	 CARVANA	 CARMAX
	Year ended 12/31/2020	Year ended 12/31/2020	Year ended 2/28/2021
Revenue	\$13,124,300,000	\$5,586,565,000	\$18,950,149,000
Gross Profit	\$2,225,600,000	\$793,765,000	\$2,379,100,000
Net income	\$470,300,000	-\$462,222,000	\$746,900,000
New vehicle units	149,203	0	0
Used vehicle units	165,097	244,111	751,862
PP&E	\$2,197,500,000	\$909,166,000	\$3,055,563,000
% of revenue	16.7%	16.3%	16.1%
% of gross profit	98.7%	114.5%	128.4%
Utilization	Service 25% / Vehicle 50%		
Capex	\$167,800,000	\$359,801,000	\$164,536,000
% of revenue	1.3%	6.4%	0.8%
% of gross profit	7.5%	45.3%	6.9%
Employees	15,100	10,400	26,889
SG&A / employee	\$94,589	\$108,285	\$70,616
Revenue / employee	\$869,159	\$537,170	\$704,755
Gross profit / employee	\$147,391	\$76,324	\$88,479
Net income / employee	\$31,146	NM	\$27,777
Units / employee	21	23	28

Source: Lithia management and company filings

Carvana, on the other hand, is “The Enron of Used Cars”:

We have a history of losses and we may not achieve or maintain profitability in the future.

We have not been profitable since our inception in 2012 and had an accumulated loss of approximately \$1.4 billion as of December 31, 2020. We incurred net losses of \$254.7 million, \$364.6 million, and \$462.2 million in the years ended December 31, 2018, 2019, and 2020, respectively. We expect to make significant investments to further develop and expand our business and these investments may not result in increased revenue or growth on a timely basis or at all. In addition, as a public company, we have and will continue to incur significant legal, accounting, and other expenses. As a result of these expenditures, we will have to generate and sustain increased revenue to achieve and maintain profitability.

We expect to continue to incur losses as we invest in and strive to grow our business. We may incur significant losses in the future for a number of reasons, including investing in growth, slowing demand for used vehicles and our related products and services, increasing competition, weakness in the automotive retail industry generally, a decline in global financial conditions that negatively impacts economic activity and employment, as well as other risks described in this Annual Report on Form 10-K, and we may encounter unforeseen expenses, difficulties, complications, and delays in generating revenue or profitability. If our rate of generating revenue slows, we may not be able to reduce costs in a timely manner because many of our costs are fixed. In addition, if we reduce variable costs to respond to losses, this may limit our ability to acquire customers and grow our revenues. Accordingly, we may not achieve or maintain profitability and we may continue to incur significant losses in the future.

There’s a high likelihood that Carvana *never* achieves sustainable profitability and ultimately ends up imploding like Enron. After all, it seems that EGII **has been following the Enron playbook** “From Day One”.

It's time to connect the dots **like the animators of *The Simpsons***. (Google doesn't like articles to have many links, but this has been relegated to a blog post, so...)

Why does a used car loan originator pretend to be a "disruptive" auto retailer?



The following are my *opinions* only:

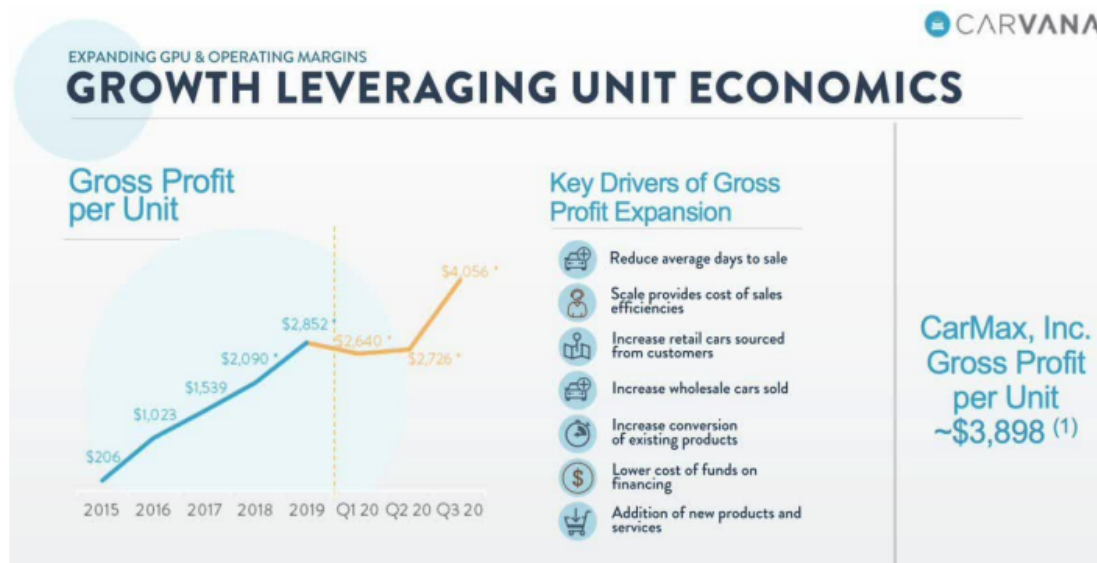
1) *They want our “investment” money.* Carvana has reportedly raised nearly \$4 billion from the capital markets despite having never generated \$1 of profit.

2) Said capital pays insiders and related-parties very well: Carvana lost **\$3,300 on every used car it sold in 2020**, but related-parties (namely *EGII's Drive Time*) were paid tens of millions and stand to gain even more through lucrative loan servicing & administration agreements (and real estate options to boot).

3) The *incessant promotion of Carvana in the financial media* as a disruptive online auto retailer and not something else (such as a lender or a pure insider enrichment scheme), allows tulip mania based on TOP LINE growth and dubious financial projections. (The perennial losses haven't mattered...but they will.)

In addition to the link above, which cites numerous—but nowhere near complete—stock promotions to retail investors in the financial media, Carvana **pumps incessantly on stock boards** and even **pitches to institutional investors**. The dubious narrative is the only constant...

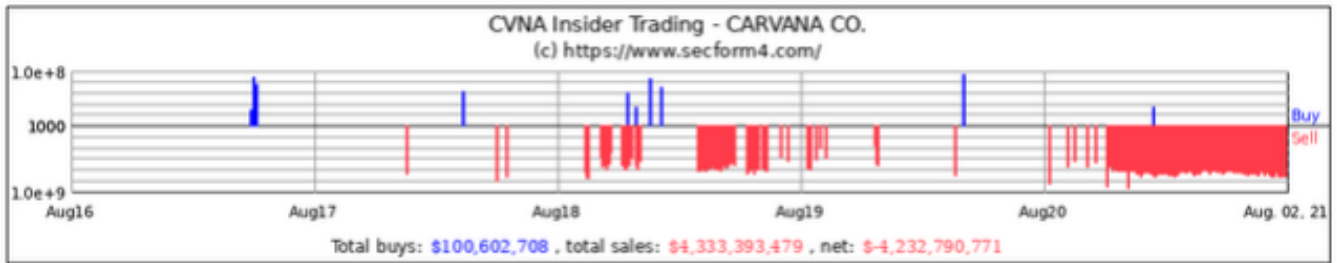
Here's a recent slide from a Carvana investor presentation. *Not only does CVNA fail to disclose that >50% of its gross profit is from related-parties and gains on loan sales, but the comparison to CarMax's gross profit is incorrect, both mathematically and conceptually.*



4) Last, but certainly not least: so that insiders can sell...and sell...and sell...

Insiders have **cashed out more than \$4 billion** despite Carvana having never earned \$1 of profit. Meanwhile, the company has raised nearly that same amount from investors.

If that sounds familiar, it's because **that's almost exactly what Enron did!**



If it looks like a duck and quacks like a duck...

It's taken Ernest Garcia II decades to perfect his pitch of selling a subprime auto lender as a capital markets darling. (**Ugly Duckling** was his first attempt.) But darling isn't the right word... **To Wall Street, This Ugly Duckling IS A SWAN!** (That's the actual title of the article.)

It's a swan indeed: Carvana is EGII's swan song. He's hit it big, having **sold billions in stock**...and who knows how much he's made through DriveTime's peculiar relationship with CVNA. But, like the lyrics to the Led Zeppelin song predicted, "his time is going to come".

Carvana's collapse will come as a shock to most, especially to millions of retail investors. Once interest rates rise (and they will, as J.P. money's printer has unleashed the inflation genie), the ponzi will collapse. Look at the cash flow statement again, and look at their loan servicing liabilities: ***Once the Fed Funds Rate passes 3%, they'll be hard-pressed to service their massive debt.***

BOTTOM LINE: I predict a Carvana bankruptcy by 2023, and I'm betting the house against this Ugly Duckling by buying OTM LEAP puts.

