TESLA - IT`S THE NARRATIVE, STUPID

As competition in the BEV segment of the car industry is heating up in earnest this year and with TESLA having failed to take advantage of its 15 year(!) head start to build a profitable and sustainable business, the only event standing between investors and a short position in the stock has been a likely solid 2H`18 as the company empties the high-priced end of its Model 3 backlog to it`s most ardent fans.

Elon Musk, in a letter to employees, just removed that hurdle on Friday, stating that Q4 will see a LOWER profit than the beefed up Q3 – on 8pc higher deliveries. Higher deliveries, lower profits. When exactly the opposite was supposed to happen, as the narrative Elon has sold to investors has been that as soon as Tesla could produce enough cars, the company would be increasingly profitable as deliveries grow. Having reported $340m in net profit in Q3, Wall Street consensus has obediently straighlined that number into a $400m est for Q4 with a FCF around the same level. That now looks to come in closer to zero, with FCF to follow. The question is how far the reality-adjustment process will take the analysts in slashing forecasts for the upcoming quarters as Q3 18 according to Elon was supposed to kick start Tesla to be «profitable every quarter from here on». True to form, the analysts have pretty much projected Q3 also into 2019, expecting the company to report 1bn net and a FCF of around $600m. That just won`t happen. Not based on the Q4 numbers, but also, more importantly, on fading demand.

GRAB

TSLA US Equity | 96) Actions | 97) Export | 98) Settings | Financial Analysis

ADJ Tesla Inc | Periodicity Quarters | Cur USD

1) Key Stats | 2) I/S | 3) B/S | 4) C/F | 5) Ratios | 6) Segments | 7) Addl | 8) ESG | 9) Custom

11) Adj Highlights | 12) GAAP Highlights | 13) Earnings | 14) Enterprise Value | 15) Multiples | 16) Per Share | 17) Stock Value

In Millions of USD	2018 Q2	2018 Q3	2018 Q4 Est	2019 Q1 Est	2019 Q2 Est	2019 Q3 Est	2019 Q4 Est
3 Months Ending	06/30/2018	09/30/2018	12/31/2018	03/31/2019	06/30/2019	09/30/2019	12/31/2019
Market Capitalization	58,478.5	45,428.7					
- Cash & Equivalents	2,236.4	2,967.5					
+ Preferred & Other	813.9	1,344.7					
+ Total Debt	11,534.0	11,779.1					
Enterprise Value	68,589.9	55,585.0					
Revenue, Adj	4,002.2	6,824.4	7,064.7	6,926.5	7,199.6	7,374.0	7,488.3
Growth %, YoY	43.5	128.6	114.8	103.2	79.9	8.1	6.0
Gross Profit, Adj	618.9	1,523.7	1,544.7	1,485.7	1,598.2	1,642.7	1,662.0
Margin %	15.5	22.3	21.9	21.4	22.2	22.3	22.2
EBITDA, Adj	-32.7	959.6	1,070.5	938.9	1,049.6	1,068.4	1,123.5
Margin %	-0.8	14.1	15.2	13.6	14.6	14.5	15.0
Net Income, Adj	-635.8	343.1	398.6	251.6	297.9	307.3	348.7
Margin %	-15.9	5.0	5.6	3.6	4.1	4.2	4.7
EPS, Adj	-3.74	1.93	2.20	1.32	1.83	1.91	2.06
Growth %, YoY	-87.9	–				-0.8	-6.5
Cash from Operations	-22.2	1,283.8					
Capital Expenditures	-609.8	-510.3	-601.3	-651.5	-691.3	-691.0	-745.0
Free Cash Flow	-632.0	773.5	374.0	83.7	273.4	195.5	239.8

Source:Bloomberg

Understanding Tesla`s shareholders

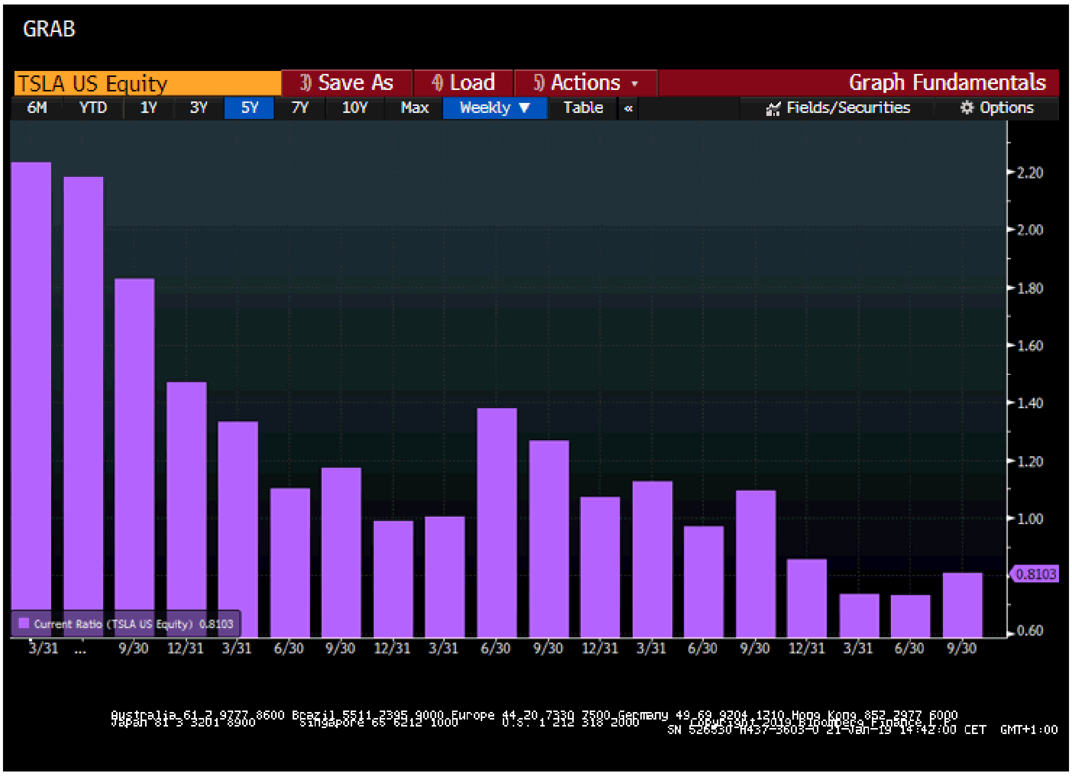
Many investors find it hard to fathom that well-known quality investors like T Rowe, Fidelity, Blackcrock a.o have patiently stayed invested in Tesla through thick and thin for years. To understand why, one needs to look at Elon`s original master plan from 2010, here https://solartribune.com/master-plan/ . Despite the turmoil, Elon has actually checked all the boxes so far and I don`t agree with those who think Tesla should be sold for every production delay, delivery hiccup etc there is. Sure, he has chronically overpromised and under delivered, but he has largely managed to stick to the overall plan, leading his investors to believe he was on the right track. With the exception of «using that money to build…(the next car)» as profitability has been non-existent and dependence on fresh capital injections has been high. Until now. And this is really the crux of it; for the first time in Tesla`s history, Elon Musk is about to fail on his Master Plan as the whole idea behind the mass market Model 3 is that this would be the car that would kick Tesla into profitability – and stay there. The question now is how patient his large shareholders will be in waiting out the Model 3 profitability. Or whether Elon is capable of selling a new, redefined narrative to his shareholders.

See, the reason investors ought to turn to a more myopic focus on Tesla now, is that as much as Elon doesn`t like it, the narrative has turned to one of profitability, rather than, as it used to be, one of coming up with new models to fulfil the dreams of dominating the worlds efforts to electrificy and how great Tesla would do if investors could just fork in another billion or two to keep him going. Time has come for Elon to deliver results on part 3 of his plan, and he`s got very little to show for himself. Tesla has now harvested 2 years of Model 3 backlog, shipping overpriced Model 3s to the starry-eyed fans who signed up for what they believe is the «iPhone of cars» paying on avg around $57k for a car that eventually will compete with other compact cars in the sub-$40k segment. Delivering these high-margin cars was Elon`s only hope to turn in a decent profit for a few qtr`s and convince capital markets that part 3 of the Plan is still on track and therefore inject more money into Tesla.

The growth narratives to issue new equity and debt on have of course been lined up already, with a new factory in China, model Y and the semi as the most important next steps. A while back, Q3`s strong showing would have been enough. As capital markets are getting wiser on the company, more was needed this time around. The poor Q4 production and delivery numbers reported just after new years was a sure tell tale sign in that regard. Even I thought the >500k reservation list meant that he`d be able to pull off at least one or even two more quarters with decent numbers, in particular in Q4 as the company has thrown everything it has at its customers to convert their reservations ahead of the halving of US tax credits. The response they`ve got on Model S and X is particularly worrying, and proves that the company is becoming demand constrained despite its claims of the opposite.

Looking into Q1, Tesla investors have every reason to get nervous. The high-priced demand in the US seems to have been filled while the tax credit issue looks set to both reduce demand and margins as Tesla is looking to pick up half of the effect by discounting it`s cars by another $2k. Struggling to make «a tiny profit» probably means Q1 consensus net will be downgraded by around $200m. Considering we are talking about Elon Musk here, the actual results will probably end up deep in the red. The company is slow in moving cars to Europe, and here competition is also heating up in earnest with Jaguar already having started to deliver a vastly superior car in the I-pace and Audi`s E-tron starts now, while Mercedes and Porsche are due later in the year. Judging by market shares in the «canary in the coalmine» Norwegian market (35pc of car sales are BEV`s…), Jaguar is wiping the floor with Tesla since starting deliveries in

October, showing up in Tesla`s global Q4 delivery numbers where S and X are actually DOWN YOY for the qtr… So much for the growth/profitability story. Tesla has never made a profit on S (except one tiny qtr) and X, and now demand is already falling as competition is heating up.



Source: Bloomberg

Despite the healthy $3bn in cash reported end Q3, Tesla`s finances are still in dire straits and it will take very little to tip the balance, as indicated by the current ratio above. Of course, if you ask about this in a quarterly conf call you`ll hardly get an answer very different from a yawn with assurances that the company will never, ever need financing again. As Elon did last year, only to admit in a recent «60 MINUTES» interview that the company was «only weeks from bankruptcy» last year. With approx $900m in customer deposits, a continued strain on cash flow as Tesla is forced to cut prices and introduce cheaper versions of Model 3 to encourage conversions and a $920m convertible due in less than 6 weeks, a large chunk of that cash may disappear in the next couple of quarters, leaving the company in an even more dire situation than last year`s near-death experience. It is really hard to see how Tesla can avoid asking capital markets for help, even if disguised as «growth initiatives» in China and/or new models. The 2025 bond has started to reflect that, yielding close to 8pc after having been issued at 5,3pc only 18mths ago, while equity investors so far have shown no worry whatsoever.

Myths

Model 3 numbers are up now as the backlog is being filled, thereafter competition arrives in earnest. I recently got an email from Tesla offering the car at an entry level price of around NOK 455k in Norway and I ended up at NOK 550k incl options (no, I didn`t buy it, of course). That is twice the price of the top-selling Leaf, and only around 10pc or so below the by far superior entry level I-pace. That just won`t fly in Norway. Or anywhere else, for that matter. Other than to its most ardent fans. The value proposition is just too poor, as demonstrated by Sandy Munro`s first teardown analysis of the car (before Tesla contacted him, it would have been great to revise last year's consultancy bills), likening it to a Hyundai assembled in 1990`s from a mechanical standpoint. Don`t believe it? Heard that Tesla is «it» and the «clear market leader in BEV»? Go check for yourself. Test-drive an I-pace. Go check out the Hyundai Kona priced some $10k below Tesla`s $48k mid-range car. Tesla will be hard pressed here, outside the US at least, unless it drops it`s prices dramatically. With a net debt of $10bn and probably back to losses in Q1, that won`t work either, unless some strange red-P&L–loving investor shows up to back it.

So, as a car company, Tesla is about to fail. It had a 15 year head start, but still didn`t make it. It was founded 8 months before Facebook(!) – not exactly a start-up anymore – and is still not profitable. Facebook made $15bn last year. And now the competition is coming… I`ve mentioned only a few as this little note doesn`t allow for the 150 or so new models on their way the next 3 years. 150…

Having watched Elon Musk`s twists and turns since Toyota and Daimler both sold their stakes and left the board back in 2014, and having met Toyota`s EV people just thereafter, I think it is worthwhile spending some time thinking about which area he could possibly turn to next to «redesign» the (lack of) profitability narrative about to take dominance over the stock. Neural nets and Full Self Driving surely must rank high on his list, in particular as one of his shareholders is out with a $4k price target based on Tesla`s possible dominance in the field. Possible, as in not having neither a product nor a market nor defined competition yet. Also, anecdotally, I notice Tesla is often mentioned alongside «other» tech companies when conversations with other investors turns to big data. And I`ve even heard analysts argue that if some US inv bank thinks Waymo may be worth $100-200bn, then Tesla`s big data «capabilities» must surely be worth the same, and that the two of them are the most important players in the field, although with two very different angles to it. Nothing could be further from the truth. There are about 20 contenders in the field, and Tesla ranks last among them. For those interested; read the links below for some background.

https://www.bloomberg.com/news/articles/2018-11-13/waymo-to-start-first-driverless-car-service-next-month

https://www.greentechmedia.com/articles/read/report-ranks-tesla-last-for-automated-driving#gs.B2Pf3yZI

http://blog.quirkyllama.org/2018/11/what-smart-tesla-fans-get-wrong-about.html

A certain FSD-value is probably discounted in the stock considering this is a company that has made a profit in 2 qtrs out of its 60 qtr lifetime and already is seeing demand dwindle at 50x 2019 consenus EPS before downgrades. Investors focus on this will increase as the top contenders in the space are moving closer to commercialisation, leaving Elon`s new clothes exposed for just what they are. As when it comes to Solarcity and Elon`s cynical use of Tesla to save his own and family`s skin in it, the best I can do is to pass it in silence. It is highly surprising that he got away with it. There is evidently very little of value there.

So, with scant value on anything but cars, valuing Tesla comes down to valuing it as a car company. After 15 years of operation, that is what it is. As the company is about to go ex growth, and it is still not able to service its debt load; I really fail to see any reason why it should be valued above its peers. Its US peers GM and Ford are at EV 0,1/0,2x sales and 2-3x EBITDA, BMW and Toyota are at EV 1x to sales and 7-10x EBITDA. With $10bn in net debt and using consensus revenue estimates for 2019 of $29bn that leaves the equity in Tesla worth maximum $20bn, or $116/shr. Maximum, because that would give Tesla the benefit of not being valued on it`s 15 year track record, but rather, in line with its successful and very profitable peers, and assuming the company will be able to start turning in a similar profit consistently very soon. Which, as shown, it likely won`t. The only carmaker faintly resembling Tesla`s multiples is Ferrari, with EV/EBITDA around 16x for 2019 and P/B in the double digits. Only Ferrari turns in EBITDA margins > 30pc consistently, pinpointing the difference to the fledgling Tesla in how real brands are able to remain super profitable with ROIC > 20pc.

Trading it

In shorting Tesla, investors may want to contemplate if they want to go up against one of the greatest stock manipulators Wall Street has ever seen. Typically, as soon as bad news are reported, investors must expect some counter-move by Elon on Twitter or elsewhere as he tries to stem the slide and stir some panic amongst the large short-base in the stock. Being humble to trading ranges may be prudent tactics in the short term. Today that means paying attention to $295-350 and the slightly wider $250-380. Having said that; the reason for this heads up from me, is that I think the conditions are now in place for Tesla`s large investors to revisit their confidence in Elon`s ability to deliver based on what will soon prove to be a failure on part 3 of the Master Plan. On top of that comes the erratic behaviour and Governance issues emerging last year, after which Elon and Tesla are still being investigated by the DoJ and are facing several class action lawsuits.

In short, after 15 years, as Elon`s EV venture is saddled with $10bn in net debt while failing to become profitable on its mass market Model 3, the Tesla growth narrative looks set to unravel over the next few quarters. Thus, Elon`s biggest backers may never allow him to pursue his «Master Plan Part Deux», including FSD and fleet sharing. Maybe, after all, that is better left with well-funded and high quality car and tech companies like BMW, Volkswagen, GM, Google a.o that have the necessary credibility with consumers broadly. Elon Musk`s legacy will hopefully and well-deservedly be as the most important executive to advance the adoption of EV globally. The rest is not much to write home about.

SELL - $100 target as the myths surrounding Tesla unravels, possibly all the way to zero unless someone picks up the brand before it`s too late.

Source: Bloomberg

Oslo 210119

Ståle