

Tesla (TSLA)

(Automotive)

Accumulate

Opening Price
\$226.95

Target price
\$500

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Initial launch success for Model X

Bloomberg TSLA US
Index NASDAQ

Gigafactory to slash costs by 30%

Significant demand for Powerwall

Market data

Market cap(\$m)	30,169M
P/E (forward est.)	120
Dividend Yield	N/A
52-week high (\$)	286.65
52-week low (\$)	181.40

Background:

Tesla Motors, Inc. is a US based company which designs, manufactures, and sells high-performance electric vehicles and electric vehicle powertrain components. The Company owns its sales and service network and sells electric powertrain components to other automobile manufacturers. It also produces and sells stationary energy storage products for use in homes, commercial sites and utilities.

Investment Case:

With astonishing performance, style and affordability that is currently unmatched by its competitor's electric vehicles, Tesla is pulling off what many prominent investors thought was impossible, revolutionising the automotive industry. Tesla stock is constantly mentioned in the news thanks to its premium market leading electric vehicles. The Model S, launched in 2012, is now three years old and still benefits from the press reporting about it as if it's a new car. Despite this Tesla's stock price hasn't moved significantly in 2015, and it's now up by a little over 3.5% for the year so far, marginally outperforming the broad based S&P 500 index. However we believe that things are looking very promising for Tesla in 2016 and beyond and it is our top pick in the green energy sector.

Firstly, Tesla's big launch of the Model X - the electric SUV, has received an excellent response, with over 30,000 bookings. Model X P90D is the safest, fastest and most capable sport utility vehicle in history. Standard with all-wheel drive and a 90 kWh battery providing 250 miles of range, Model X has ample seating and space for up to seven adults plus luggage. Recently it has been announced that it will be aggressively priced between £50,000 and £90,000 and the first UK deliveries are due in 2016.

Secondly, Tesla's \$5 billion gigafactory in Nevada (the centrepiece of its mass-market electric car strategy) has recently started to produce batteries. Remarkably, the factory will produce as much renewable energy from its solar cells as it uses (net zero energy). This is expected to lift sentiment, given that the company will be able to ramp up

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production of batteries for both cars and homes significantly within a year. It's also expected to slash costs by at least 30% through economies of scale and high-tech manufacturing. What's also interesting is the \$1.4 billion tax incentive package lawmakers handed Tesla, which was 13 times larger than the state's previous record-breaking deal awarded to Apple for a data centre project in 2012. If all goes to plan, Tesla will essentially operate tax free for a decade and at a substantial tax discount for another 10 years. The actual value of the incentives will depend on how many jobs are generated and how much the company actually invests.

Thirdly, from the beginning Tesla's long-term goal has been to develop and manufacture an affordable and attractive electric vehicle for the masses. CEO Elon Musk believed that the only way a new electric car company could survive is by instilling a desirable luxury car appeal and selling high-margin cars when sales volumes are low. This would help the brand increase demand as they move towards producing cheaper cars, increasing their market share. With a rumoured price of \$35,000, Tesla is hoping that the Model 3 will help the company sell 500,000 cars in 2020. Tesla is planning to showcase a Model 3 prototype in March 2016 and first deliveries are expected in the middle of 2017. Power for the Model 3 will come from batteries produced in Tesla's new gigafactory. Elon Musk has stated clearly that it won't look like other cars and the motoring press expect it to have a level of performance that would at least match BMW's M3 and M4 supercars. As with the Model S and the upcoming Model X, the Model 3 will come with free use of Tesla's Supercharger network, which Musk said will enable Tesla owners to drive the length and breadth of the UK by the end of 2015.

Fourthly, Tesla's home battery 'Powerwall' - which connects to solar panels on the roof of a house and aim to store enough power during the day to drive kettles and washing machines at night, has seen great interest and demand from US consumers. After launching in April and priced at \$3000, the Powerwall was sold out until mid-next year. Tesla has managed to sell 50,000 units of the Powerwall within the first few weeks of the launch. They recently hinted that Powerwall was ready to enter the UK market and that its units will go on sale in Australia by the end of the year. Germany is expected to be a perfect market for Tesla due to the country's sky-high energy tariffs. This has created a vibrant market for energy storage solutions as the country boasts circa 39GW of installed solar system. However, Germany may be a challenging marketplace as there are already a number of competitors working its solar energy space. That said, Tesla might beat them if it can work out a price system that would attract German buyers. Right now, batteries sell for about 1,000 Euros per kilowatt peak (kWp) and the average 4-person households need a 5kWp unit. Tesla sells its 7 kWp Powerwall for 3,615 Euros at the wholesale level. If Tesla can find a way to make sure that the Powerwall units sell at a cheap retail price, its energy business could get off on the right foot in Germany and the firm would find it easier to win over the other markets in Europe.

Tesla's earnings per share have declined consistently, due in part to the additional investment in R&D. However, revenue has grown at a good pace. If all proceeds as planned, falling battery costs should help Tesla either price their cars more aggressively, or focus on expanding profit margins. Tesla has halved the unit cost of its packs, with costs expected to drop further to about \$150 a kilowatt/hour once Tesla's gigafactory is fully running. In contrast, Tesla's competitors use (lithium ion) batteries that are expected to cost \$250/kWh in 2020.

Overall next year looks good for Tesla. However, given Tesla's valuations at 120X forward earnings and 8 times sales, this could limit the upside potential of the stock in the short term should there be an unforeseen event. Due to the current high valuation it would be prudent to commence building a long term position in Tesla over two or three stages over the next 12 months. This strategy would help avoid the risk of staying out of the green energy market altogether which is estimated to be worth \$600 billion according to a recent report from Goldman Sachs, whilst offering some protection should a price correction ensue.

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Key Risks:

Tesla are making the big car manufacturers notice the potential in the electric car market. Although Tesla are raising the bar as to what we expect from their new cars, they're not perfect. They're fallible just like every car company. They will face increasing competition from the big existing car makers, who make millions of cars per year already.

Toyota the world's leading producer of battery-hybrid vehicles, is not creating a pure battery-electric car to compete with Tesla. Instead Toyota's R&D team came to the conclusion that recharging time would prove to be an insurmountable obstacle in the mass adoption of battery-electric cars. Even with Tesla's vaunted "Superchargers," it takes 30 minutes to charge to 80 percent capacity. Currently, Tesla's vehicles do have the longest range of any electric vehicle, but they also have the highest cost. With the gigafactory, Tesla aims to use the economy of scale to bring down the price of its technology, and thus of its vehicles.

Elon Musk claims that Tesla has quite a good understanding of all the battery technologies in the world. Although Musk has acknowledged that there is a slight chance that there could be new battery technology being developed elsewhere, Musk believes that it would make commercial sense for any new battery technology to approach Tesla and use the company's existing product channels to license the latest revolutionary battery technology.

Tesla is expected to move back into the green early in 2016, especially once the revenue from its 'Model X' edition starts pouring in. However there are of course risks that sales will fall short of expectations and thus disappoint investors who are currently happy to hold the shares with an expensive valuation and high multiples.



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